IN THE

# Supreme Court of the United States

October Term, 1940.

## No. 624.

PHOENIX FINANCE CORPORATION, a Corporation of the State of Delaware,

*Petitioner,*

*v.*

IOWA-WISCONSIN BRIDGE COMPANY, a Corporation of the State of Delaware,

*Respondent.*

# BRIEF FOR PETITIONER.

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## FOREWORD.

The primary question herein as to the scope and legal effect of the alleged former adjudications, including the defense of *res adjudicata* and thereby involving the Full Faith and Credit Clause (U. S. Const., Art. IV, Sec. 1), has heretofore been decided adversely to the respondent by the Superior Court of Delaware.

> *Phoenix Finance Corporation v. Iowa-Wisconsin Bridge Co.*, 14 Atl. (2d) 386.

Writ of error to the Supreme Court of Delaware was taken by the defendant (the respondent herein) (No. 4 October Term 1940). Case briefed and argued orally on January 30, 1941 (see Clerk's Certificate in Appendix) and is pending decision.

The above cited Superior Court case is the law of the State of Delaware pending the decision of the Delaware Supreme Court.

> *West v. American T. & T. Co.*[1] (not yet officially reported; Decision Dec. 9, 1940, Nos. 44, 45).

Accordingly, there exists a conflict between the law of the State of Delaware and the law as announced in the Eighth Federal Circuit (115 Fed. (2d) 1; 32 Fed. Supp. 277) in the cause to which this writ of certiorari is directed.

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[1] 61 S. Ct. 179; 85 L. ed. 146.

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## BRIEF FOR PETITIONER.

### OPINIONS BELOW.

The opinion of the District Court below (R. 717-722) dated March 23, 1940, is reported in 32 Fed. Supp. 277. The opinion of the Circuit Court of Appeals (R. 767-787) is reported in 115 Fed. (2d) 1. The granting of certiorari herein is not yet officially reported.[1]

The attention of the court is directed to a case in the Superior Court of Delaware between the same parties and involving the same principal subject matter opposed to the foregoing (*Phoenix Finance Corporation v. Iowa-Wisconsin Bridge Company,* 14 Atl. (2d) 386). This case is pending decision on writ of error to the Delaware Supreme Court (see Clerk's Certificate in Appendix).

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[1] Granted January 20, 1941; 85 L. ed. 392.

In the Mortgage Foreclosure Cause [2] to which the proceedings below were supplemental and ancillary, the opinions of the District Court and Circuit Court of Appeals are reported in 19 Fed. Supp. 127 and 98 Fed. (2d) 416 respectively. In that cause, certiorari to this Court was denied (No. 438 October Term 1938; 305 U. S. 650, 676).

## JURISDICTION.

Writ of certiorari was prayed and granted herein pursuant to the authority of Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 (43 Stat. 938; 28 U. S. C. A., Sec. 347 (a)).

The reasons relied on for the exercise by this Court of its judicial discretion under the above cited Section were stated in subheading IV of the Petition for Writ of Certiorari (pp. 14-19). Upon the reasons thus stated, this Court has granted certiorari.

## QUESTIONS PRESENTED.

Basically, there is involved herein the construction by the Supreme Court of the decree of December 1, 1936, in the Foreclosure Cause in the District Court (F. R. 156) as affirmed by the decree (F. R. 1709) and mandate (R. 697) of the Circuit Court of Appeals in that cause. The two major questions as to the effect of the foreclosure decree relate to: (1) the effect of that decree as an adjudication against Phoenix, an involuntarily impleaded party complainant, of Phoenix' legal claims on notes, contracts and open accounts, and Bridge Company's unpleaded counterclaims or set-offs with respect thereto, and (2) the right of Phoenix as the defendant in the Supplemental and An-

[2] This record, designated and distinguished as "Foreclosure Record" or "F. R." is an exhibit to and part of the record herein.

cillary Cause to challenge the Foreclosure decree under "Lord Redesdale's Rule."

Primarily, therefore, it is the petitioner's contention that the District Court in the Foreclosure Cause was without jurisdiction to adjudicate against it in a cause (1) where it was but a "formal" party (F. R. 211), and (2) where such purported adjudication was not responsive to issues involved. The construction of a prior decree involving a determination of the scope of the jurisdiction of the court rendering the prior decree is a proper matter to be considered by the Supreme Court on writ of certiorari.

> *St. Louis, etc., Railroad Company v. Wabash Railroad Company, etc.*, 217 U. S. 247;
> *Baltimore & Ohio R. R. v. Parkersburg*, 268 U. S. 35;
> *KVOS, Inc. v. Associated Press*, 299 U. S. 269.

The existing conflict between the Circuit Court of Appeals and the Superior Court of Delaware (14 Atl. (2d) 386) and, in the event of an affirmance on pending writ of error, the Supreme Court of Delaware [3] relating to the construction and legal effect of the decree of December 1, 1936, in the Foreclosure Cause, is an important consideration calling for review by the Supreme Court of the decrees below.

> *Forsyth v. Hammond*, 166 U. S. 606.

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[3] See Certificate of Clerk of Supreme Court in Appendix.

## STATEMENT OF THE CASE.

### Preliminary Statement.

As an initial approach to a consideration of the case the Court is respectfully referred to the "Summary Statement" as contained in the Petition for Writ of Certiorari. The statement of *detailed* facts as hereinafter contained is necessarily enlarged and extended to include *all* facts deemed material to a consideration of the questions now before the Court under alternative arguments. Such facts are stated herein as concisely as the nature of the case and the size of the *two* Records will permit.

### Nature of the Cause of Action and the Scope of the Decree to Which Certiorari Is Directed.

The cause of action in the District Court below was on Supplemental and Ancillary Bill of Complaint (R. 3) [1] in which Iowa-Wisconsin Bridge Company, a Delaware Corporation (herein sometimes referred to as "Bridge Company"), was complainant and Phoenix Finance Corporation, a Delaware Corporation (herein sometimes referred to as "Phoenix"), was defendant. The Supplemental and Ancillary Bill was filed for the alleged purpose of making effective and securing to the Bridge Company the supposed fruits and benefits of a decree in the District Court dated December 1, 1936 (F. R. 202; R. 66) [1] in a cause of action in equity for mortgage foreclosure filed by the Trustees of a certain mortgage deed of trust, as the

[1] Wherever in this brief record reference is designated as "R" the printed record on Certiorari to the Supreme Court of the United States is intended. Whenever the record reference is designated as "F. R." the printed record on appeal to the Circuit Court of Appeals for the Eighth Circuit in the Mortgage Foreclosure Cause is intended. The "Foreclosure Record" is an exhibit to the "Record" in this cause.

complainant-mortgagees and to which the Bridge Company, as the mortgagor, was defendant (F. R. 1).

The status of Phoenix Finance Corporation, a bondholder, subsequently brought in involuntarily as a "formal" party (F. R. 210-211; 19 Fed. Supp. 127) complainant (F. R. 85) in said Foreclosure Cause, the issues of said cause and the scope and legal effect of said decree of December 1, 1936, *denying foreclosure* are matters of principal importance herein.

Phoenix as the holder of more than 25% of the bonds secured by the deed of trust had requested the Trustees to foreclose, Exhibit 28 (H. E. B.); F. R. 789-791). The deed of trust specifically provided for foreclosure in the event of default, upon the written request of the holders of 25% in principal amount of the bonds in respect of which default existed (F. R. 35, Sec. 2 (b)). In the request for foreclosure Phoenix agreed to secure and indemnify the Trustees against costs, expenses and liabilities incurred by them in connection with the proposed action (F. R. 790). Phoenix also requested the ~~Trustees~~ to retain designated counsel and agreed to indemnify the Trustees "for fees and expenses in connection with the litigation" (Exhibit B (H. E. B.), F. R. 794).

The agreement to indemnify the Trustees for costs and expenses is explained by the testimony of the Vice President of the corporate trustee (F. R. 537):

> "Before taking any action in the foreclosure, we asked the Phoenix Finance if they would protect us against expense and indemnify us against costs. We have the Phoenix Finance Corporation's agreement to pay costs of foreclosure, and the deposit with us at that time. * * *

Following the designation by Phoenix Corporation of the attorneys to act in the foreclosure of the bonds and the guaranteeing of the expenses in connection therewith, we designated the said attorneys named by them, and the litigation has proceeded under the supervision of said attorneys."

The Supplemental and Ancillary Bill sought (1) injunction, both temporary and permanent, against Phoenix from prosecuting or carrying forward certain actions (five at law and one in equity) in the courts of the State of Delaware, (2) an injunction, both temporary and permanent, against Phoenix from instituting or carrying forward any other actions either in Delaware or elsewhere, (3) a mandatory order requiring Phoenix to dismiss the Delaware actions, (4) an injunction, both temporary and permanent, against Phoenix from foreclosing or otherwise acting with respect to certain \$50,000 [2] mortgage on Bridge Company property located in Iowa and Wisconsin and given by Bridge Company to Phoenix Finance System, Inc., under date of March 10, 1931, and (5) a mandatory order requiring Phoenix to satisfy said mortgage both in Iowa and Wisconsin and to surrender to the District Court for cancellation said mortgage and the note secured thereby (R. 11-12).

Preliminary injunction with mandatory order as prayed was granted (R. 132) two days before the Answer of Phoenix was due or filed. Phoenix thereupon filed its Answer and Cross-Bill which upon motion was stricken by

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[2] This mortgage is not to be confused with the \$200,000 mortgage deed of trust which was the subject matter of the Foreclosure Cause. The \$50,000 mortgage was security for further advances over and above the original loan of \$50,000. The \$9,000 item hereinafter mentioned is a part of such further advances.

order of the District Court[3] (R. 749). Phoenix next filed its Answer and Counterclaim (R. 146) and certain portions thereof were, upon like motion, stricken by order of the District Court (R. 171).

Pursuant to the rules of the District Court for the Northern District of Iowa, Phoenix thereupon gave notice of intention to take the depositions of certain witnesses (R. 172) including George E. Preuss, Edgar S. Gage, Lee J. Skoner, Albert Penn and John A. Thompson. In due course and in conformity with the Rules of Civil Procedure, Phoenix gave further notices of the times and places of the taking of the depositions of said witnesses (R. 173, 174, 224, 225), whereupon the Bridge Company moved for and obtained temporary stays and, upon hearing, final orders that said depositions be not taken (R. 184, 223, 232, 256). To each such motion, Phoenix filed a comprehensive resistance (R. 192, 238) which contained full and complete schedules of the testimony of all such witnesses with relevant exhibits were set out.[4]

Upon final hearing, Thompson, Penn and Skoner together with one Emory H. English were produced as wit-

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[3] In view of the fact that allegations of the same general import as contained in the Answer and Cross-Bill of Phoenix were likewise stricken by order of the District Court from the subsequent Answer and Counterclaim of Phoenix, the petitioner has omitted said Answer and Cross-Bill and the motions and order for the striking of the same from the record. Any error in the order striking the Answer and Cross-Bill is implicit in the order striking portions of the New Answer and Counterclaim, in the order denying to Phoenix the right to take certain depositions and in the rulings of the District Court denying to Phoenix the right to offer any testimony on its behalf.

[4] See the following schedules of testimony: John A. Thompson, R. 205; Albert Penn, R. 197; Lee J. Skoner, R. 221; Edgar S. Gage, R. 218, and George E. Preuss, R. 217. See also as an exhibit to the first such Resistance the report of Special Examination of the accounts of Iowa-Wisconsin Bridge Company entitled: "Receipts and Disbursements, Iowa-Wisconsin Bridge Company, Lansing, Iowa, November 1, 1930 to September 25, 1933," as prepared by said Preuss of Ernst & Ernst, Accountants and Auditors, Chicago, Illinois, under the direction of the said Skoner (R. 218, 222, 595-693). This same exhibit was offered in evidence as Defendant's Exhibit SC114 (R. 292).

nesses on behalf of Phoenix. Their tendered testimony was rejected by the District Court (R. 286-287, 291, 292). At the final hearing there were offered in evidence complete exemplified copies of the Delaware proceedings (Defendant's Exhibits S. C. 101, R. 385; S. C. 102, R. 440; S. C. 103, R. 482; S. C. 104, R. 522, and S. C. 105, R. 546). The exact nature and present status of each such action is more fully set forth under an appropriate heading of this Statement. The $50,000 mortgage showing the recording thereof in Allamakee County, Iowa, and in Crawford County, Wisconsin, is in evidence as Bridge Company's Exhibits S. C. 6, R. 374, and S. C. 7, R. 379.

*Phoenix' primary defense was one of law, viz, that the decree in the Foreclosure Cause did not and legally could not constitute an adjudication against it with respect to said Delaware actions and with respect to said $50,000 mortgage and note.* Phoenix' secondary defense as raised by the stricken portion of its Answer and Counterclaim and the tendered and rejected testimony of its witnesses, was want of equity, unclean hands and the particular application of said defenses in supplemental proceedings known as "Lord Redesdale's Rule." By the allegations thus stricken and the evidence thus rejected Phoenix sought to show that the Foreclosure decree was not a "right" one, that the same was induced by misrepresentations and fraudulent tactics on the part of intervener, his counsel and an associate and that the Bridge Company, as complainant in the Supplementary and Ancillary Cause, was in court with unclean hands and had failed to do equity (R. 272-292).

Due to the striking of a large part of the Answer and Counterclaim of Phoenix, the denial of its right to take

depositions and the rejection of evidence offered at the hearing, the decree of the District Court (R. 719) was in practical effect a judgment on the pleadings against Phoenix. *The District Court decided adversely to Phoenix, its primary contention that the Foreclosure decree was not a valid adjudication against it.*

By the Findings of Fact, Conclusions of Law (R. 700) and Memorandum Opinion (R. 717), the District Court held as follows:

1. That all of the issues and controversies involved in the Supplemental and Ancillary Bill were litigated in the Foreclosure Cause and were adjudicated adversely to Phoenix by the decree of December 1, 1936.

2. That although Phoenix was but a "formal" party in said Foreclosure Cause, it nevertheless was "represented" by the Trustee Complainants and that all of its claims against the Bridge Company (including unpleaded setoffs and counterclaims of the Bridge Company against it) had been fully adjudicated.

By the final decree of the District Court dated March 23, 1940 (R. 719), and the writ issued in pursuance thereof. the following injunctive and mandatory orders were made against Phoenix:

1. That it be permanently enjoined and restrained from prosecuting, conducting or carrying forward in any manner whatsoever any and all of the Delaware actions.

2. That it forthwith dismiss all said actions at its own cost.[5]

3. That it release, satisfy and remove from record both in Allamakee County, Iowa, and Crawford County, Wisconsin, said $50,000 mortgage of March 10, 1931.

4. That it deliver the original of said mortgage and the note secured thereby to the Clerk of the District Court for cancellation.

5. That it be permanently enjoined and restrained from commencing, prosecuting or bringing in question, or in any manner carrying forward any suits or causes of action claimed to be involved in the Findings of Fact and Conclusions and Decree of December 1, 1936, and Order denying rehearing and modification of March 4, 1937.

The decree of the District Court was affirmed by the Circuit Court of Appeals for the 8th Circuit (R. 787; opinion, R. 767).

**The Parties, Pleadings, Issues and Decree in the Foreclosure Cause.**

*The cause to which the proceedings below were supplemental and ancillary was typically one for the foreclosure of a deed of trust.* The deed of trust covered real and personal property of the Bridge Company located in the States of Iowa and Wisconsin. The complainants were the

[5] The Delaware law action described in paragraph (a) of the decree (R. 720) had theretofore on March 18, 1940 been decided by the Superior Court of Delaware in favor of Phoenix and judgment entered against the Bridge Company (14 Atl. 2d 386). The sole defense in that action was *res adjudicata* based upon the decree of December 1, 1936 in the Foreclosure Cause. The court rejected the plea. This case argued on Writ of Error to Supreme Court of Delaware January 30, 1941 and decision is now pending. (See Certificate of Clerk in Appendix.)

Trustees created by the deed of trust. One trustee was a corporation of Iowa, the other an individual, a citizen and resident of Wisconsin. The Bridge Company, defendant, is a Delaware corporation. *Therefore Federal jurisdiction as to the issue of mortgage foreclosure existed.*

The bill of complaint (F. R. 1-11) prayed (1) for an account of all the property in the District subject to the lien of the mortgage deed of trust and that the same be declared a valid lien thereon; (2) that an account be taken of the bonds and interest coupons secured by the mortgage deed of trust and that the defendant be decreed to pay to the complainants the amount found to be due on such accounting and in default of payment that the mortgaged property be sold under decree of court; (3) that any bondholder or any committee of bondholders or the complainants might bid for and purchase the property at said sale; (4) for a deficiency judgment in the event the proceeds of the sale should not be sufficient to satisfy the decree in full; (5) for the appointment of a receiver of the property; (6) that the account of the complainants, as Trustees, be examined and approved; and (7) for general relief.

The Bridge Company by its answer to the bill for foreclosure (F. R. 62-66) denied "that said mortgage deed of trust is a valid and binding lien upon the property as alleged in the complainants' bill." The answer also stated that "defendant believes that a large portion of said bonds were improperly executed and delivered," that the management of the Bridge Company had been controlled by persons who were officers or stockholders of Phoenix Finance System, Inc. (not Phoenix Finance Corporation, the petitioner), that all transactions between the Bridge Company and Phoenix Finance System, Inc. "should be scrutinized by the court with the greatest care," and *that*

*any preference shown Phoenix Finance System, Inc., should be set aside.*[6]

The answer prayed the court "to deny complainants the appointment of a receiver and to compel complainants to make a complete showing and accounting * * * of the method and manner in which bonds were sold and delivered, the consideration paid and received therefor; and to compel complainants to show in what manner the bonds authenticated by the Trustees were disposed of."[7]

In the amended answer (F. R. 68) the Bridge Company prayed that the Trustee Complainants make a full showing and accounting of its actions in connection with the trusteeship and "*that the court compel said complainants* [i. e. the Trustees] *to surrender to the clerk of this Court for cancellation any and all bonds improperly delivered* * * *."[8]

Following the filing of the answer the court appointed a receiver of the mortgaged property (F. R. 68-72). Thereafter one Fayette D. Kendrick, a Bridge Company stockholder, sought and was granted leave to file a petition of intervention (F. R. 73-85). This petition contained certain averments of fraud and prayed (1) that the intervener be permitted to intervene on behalf of himself and in be-

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[6] It is to be noted that the determination of such an issue (if in fact an issue) would have required the presence in the case of Phoenix Finance System, Inc., a Delaware corporation, as an indispensable party. As to such issue the Trustees had no interest. At this point the Receiver had not been appointed. Obviously, therefore, the required diversity of citizenship as to this alleged issue could not have existed.

[7] Note that the Trustees had no connection with or knowledge of the sale or delivery of the bonds by the Bridge Company to the Bondholders. (F. R. 536, 537.) The bonds were unregistered.

[8] Here again it will be apparent that if the answer be construed as tendering an issue with respect to the cancellation of the debt, Phoenix Finance Corporation and other bondholders whose bonds were attacked would have been indispensable parties (Clemons v. Elder, 9 Iowa 272). As to such issue there could be no Federal jurisdiction because Phoenix as such bondholder and the Bridge Company were corporations of the same state necessarily arrayed on opposite sides of the controversy.

half of all others similarly situated; (2) that the complainants' bill be dismissed; (3) that certain corporations (*not Phoenix Finance Corporation*) be ordered and directed to deliver to the office of the clerk of the court for cancellation bonds issued under the mortgage deed of trust and *that said bonds be cancelled;* [9] (4) that the deed of trust be held for naught and set aside; and (5) for general relief.

Following the filing of the intervention petition, a motion was made by the intervener (F. R. 83-84) that certain corporations (including Phoenix Finance System, Inc., but not the petitioner, Phoenix Finance Corporation) be made "parties defendant herein".[10] The first reference in the proceedings to Phoenix Finance Corporation is contained in an order of a District Judge [11] granting the petition for intervention (F. R. 85-86) which is in part as follows:

> "* * * and complainants' counsel having stated in open court that the Phoenix Finance Corporation has succeeded the Phoenix Finance System, Inc., and is the owner of the bonds involved in this action with the exception of about $10,000 worth of said bonds, it is hereby ordered and directed that the Phoenix Finance

[9] It seems obvious that the Master and the Court in the Foreclosure Cause gave the same effect to the intervention petition as though it had been a proper Cross-Bill in the right of the Bridge Company and against Phoenix Finance System, Inc., *for cancellation of bonds.* In fact the intervener in certain resistances filed in the Foreclosure Cause refers to his petition as a "Cross-Bill" and Phoenix' answer as an "answer to cross-bill" (F. R. 207, 393).

[10] It will thus be seen that the intervener sought to make Phoenix Finance System, Inc., a party defendant *to the cause stated by his petition*, viz., *a cause for cancellation of bonds.* As to such an issue Federal jurisdiction was lacking.

[11] In a supplemental opinion after final decree the District Judge who rendered the decree said (F. R. 208): "In the absence of the Judge of the District, Judge Molynaux of the District of Minnesota was holding the December, 1933, Term of Court at Dubuque, Iowa, and entered an order for the bringing in of Phoenix Finance Corporation as a co-plaintiff with the trustees. Whether the citizenship of Phoenix Finance Corporation was at the time given any thought does not appear." Obviously, therefore, the status of Phoenix, a Delaware corporation, as plaintiff in an action in which Bridge Company, a Delaware corporation, was defendant, was deemed a matter of sufficient concern to inspire this rather unique explanation.

System, Inc., and the Phoenix Finance Corporation be made parties *plaintiff in this cause* and *defendant to the petition of intervention,* and the clerk of this court is hereby directed to issue the necessary processes and summons for said purpose." (Emphasis supplied.)

There were no pleadings of any character directed against or naming Phoenix Finance Corporation, this petitioner. Phoenix was brought into the case solely by virtue of the above mentioned *ex parte* statements of counsel for the Trustee Complainants.

The distinction between Phoenix Finance System, Inc., and Phoenix Finance Corporation, this petitioner, is not a captious or technical one. The intervention petition charges acts of fraud on the part of Phoenix Finance System, Inc., occurring in 1930 and early 1931. Phoenix Finance Corporation was not incorporated until December 29, 1931 (F. R. 542). The relationship between these corporations was simply that of vendor and vendee, respectively, of certain assets. As of January 1, 1932, Phoenix Finance System, Inc., made a sale of certain (but not all) of its assets to Phoenix Finance Corporation and received cash and securities as the consideration therefor. Phoenix Finance System, Inc., was sometime later dissolved and distributed its assets to its stockholders (F. R. 636, 673, 674, 691). *There was no merger, consolidation, corporate identity or succession.*[12]

THE "TWO-STAGE" THEORY OF THE PARTIES.[12a]

The Foreclosure Cause was tried before the Special Master on the theory that the sole issue for determination

[12] This question was decided in *Argenbright et al. v. Phoenix Finance Co. of Iowa*, 187 Atl. 124, 126 (Del. Ch.) and *Graeser v. Phoenix Finance Co. of Des Moines*, 254 N. W. 859 (Iowa).

[12a] A consideration of the facts under this heading and the next heading "The Non-Participation of Phoenix at the Trial" (p. 17) is not necessary if

at the first stage of the case was whether or not the mortgage deed of trust was a valid instrument and that if *any* of the bonds issued by the Bridge Company were valid, that a decree of foreclosure and sale should be entered, reserving for final determination in the second or subsequent stage, the question as to which of the bonds were entitled to participate in the proceeds of the sale of the mortgaged property. The understanding of the attorneys for the respective parties and of the Master as to these two distinct stages of the proceedings, is well established by the record [13] and is in conformity with established practice.

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the court shall agree with petitioner's primary position, *viz.*, that the status of Phoenix as a *formal* party and the absence of justiciable issues as to it in the Foreclosure Cause, rendered the Court incapable of adjudicating against it. The same result is reached if Phoenix were an "indispensible" party and the jurisdictional requirement of diversity of citizenship thus removed.

[13] In the complete transcript of the testimony taken by the Master at Des Moines July 15 to 20, 1935, of which a partial or narrative statement only is included in the printed record of the Foreclosure Cause (F. R. 531 *et seq.*), it will be found that at the beginning of the hearing, counsel for the intervener and the Bridge Company objected to testimony with respect to the bonds without their physical production and proof. Counsel for the Trustee complainants thereupon propounded the "two stage theory" and the evidence without the bonds being proven was admitted. With respect to other collateral issues, the Master by his rulings contemplated a later stage of the proceeding. At F. R. 551 he said: 'These side issues is something that must be tried out *at a later date*." With respect to the producing of the books of Phoenix Finance System, Inc., to show the $35,000 as consideration for bonds, the Master said: "We will take that question up later." At F. R. 561, the Trustee complainants rested "reserving, if it is agreeable with the Master, the right to discuss with him the question of proving of these actual bonds that are outstanding, *which I think can be taken up at a later date.*" Counsel for the Bridge Company reserved the right to present testimony *later*. At F. R. 637, counsel for the intervener requested production of the bonds and the Master ruled that "it is immaterial *at this time.*" See also F. R. 451, where counsel for the Trustee complainants referred to the question with respect to the bond issue as being "subsequent" to the question of the validity of the mortgage.

At Mason City, July 22 to 24, 1935, further testimony of Intervener's witnesses was taken by the Master, a partial or narrative record of which appears in the printed record of the Foreclosure Cause (F. R. 653 *et seq.*). At F. R. 691, counsel for the intervener moved to dismiss "on the ground that the complainants have wholly failed to produce or account for the bonds in suit and therefore are not held to have established cause of action." The Master after "long discussion of counsel" (F. R. 692) gave specific instructions concerning briefs, but said (F. R. 693): "I think I have their theory, however, about it not being necessary to produce the bonds *at this time.*" The Master did not grant the application to dismiss and must therefore be assumed to have acquiesced in that theory of a later or second stage for proof of the bonds.

Defendant's Exhibit SC-106 in the instant case (R. 584) is a letter written by the attorney for the Trustee complainants to the Master on July 25, 1935, immediately following the Mason City hearing and in response to a request by the

The case never reached the second stage. The hearings before the Master, upon the basis of which he made findings of fact, related solely to that first procedural stage. Although the Master's report, filed March 10, 1936, recommended foreclosure, no provision was made for the bondholders to prove their obligations and the considerations therefor if contested. Phoenix duly excepted on this point (F. R. Suppl. 58, 3), but was denied relief (F. R. 203).

At the trial of the Supplemental and Ancillary Cause, Phoenix' counsel made the following tender of evidence (R. 277-278):

> "We further desire to offer testimony by Mr. Thompson to show that Phoenix Finance Corporation at no time in this case had an opportunity to offer evidence on its behalf, although it at all times was ready, willing and desirous of so doing. Your Honor held in this case that the trustees had exclusive control of the litigation. Mr. Rex Fowler was the attorney for the trustees. We propose to show through Mr. Thompson that he was told by Mr. Fowler that the time had not come for Phoenix to take any part in the proceedings, that the evidence offered against Phoenix

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Master (F. R. 693) that the complainants supplement their prior oral statement as to "their theory of the case." Mr. Fowler, as attorney for the Trustee complainants, wrote in part: "It is to be remembered at all times in the instant case that the validity of the mortgage deed of trust and the several bonds issued thereunder *is being asserted by the trustees under the mortgage deed of trust and not by Phoenix Finance Corporation.*" He then pointed out that, the litigation not being between the Bridge Company and Phoenix, the complainants had met the requirement of proof on its part as to the validity of the mortgage and bond issue.

For further proof of the definite understanding with respect to the "two-stage" theory, see affidavits of the various counsel involved (F. R. 224, 226, 228) and of certain of the witnesses present but released to return for the second stage of the proceeding (F. R. 258, 280, 355 and 368).

Arguments of counsel before the Master and before the District Court are not part of the *printed* record on appeal in the Foreclosure Cause. The *complete* Mason City and Des Moines transcripts are not given. *Complete* transcripts of all such arguments (with briefs in support thereof) and of such hearings are, however, included in the record below in the Foreclosure Cause and at the final hearing on the Supplemental and Ancillary Bill counsel for the Bridge Company asked the court to judicially notice the "transcripts of such evidence" and "all the records, papers and files" in the cause (R. 260).

> by the interveners was premature and not necessary; that there had been a prima facie showing of consideration for the bonds, and that at that time it was not necessary for Phoenix Finance Corporation to rebut any of the evidence so offered.
>
> We desire to prove through Mr. Thompson that Phoenix Finance Corporation had its witnesses physically present on one or more days at the hearing before the Master to testify, ready to testify on all of the issues which are now being asserted against it, and that Mr. Fowler, the attorney for the trustees, who had control of the litigation, stated it was not necessary at that stage of the proceeding."

The evidence thus tendered was rejected by the court (R. 287).

The Non-Participation of Phoenix at the Trial.

Phoenix did not participate in the trial of the Foreclosure Cause before the Master. It offered no evidence and no argument was made on its behalf by counsel at any hearing before the Master. The trustee complainants had "exclusive control" of the litigation, according to the District Court (F. R. 211). In connection with a petition for writ of certiorari to this Court in the Foreclosure Cause (No. 438, October Term, 1938) counsel for the Trustee complainants (Rex H. Fowler, Esq., and Charles S. Bradshaw, Esq.) filed certain "Suggestions" in part as follows:

> "The Trustees presented the case in the District Court on the theory, believed to have been accepted by the Master in Chancery, that only one issue was then up for consideration, namely, the right to a foreclosure of the Mortgage Deed of Trust, and assumed that the question of the validity of the bonds would not be taken up until after a foreclosure was ordered (R. 224-230).

That is to say, the trustees never pretended to represent bondholders for any other purpose except that relating to the security under the mortgage.

At no time, did Counsel for the trustees attempt to prove the validity or disprove the invalidity of any individual bonds, as such. With the controversy between the mortgagor and the bondholders relating to the validity of individual bonds, the trustees felt they had nothing to do. Petitioner Phoenix Finance Corporation, the only bondholder in Court, was represented by its own Counsel (R. 91-92, 228-230).[14]

Counsel feel that if bondholders are to assume that they were represented in the courts below by us, they have reason to be dissatisfied with their representation."

W. B. Sloan, Esquire, counsel for Phoenix had entered his appearance in the case (F. R. 89). In an affidavit filed by Mr. Sloan in connection with a petition for modification of the Decree in the Foreclosure Cause, Mr. Sloan said (F. R. 228-230):

"* * * Bradshaw, Fowler, Proctor & Fairgrave of Des Moines, Iowa, were attorneys for Complainant Trustees in the case and had the view, as I understood it, that proper procedure was first to determine the validity of the Mortgage Deed of Trust and that at a later hearing the question would be considered of proving up the particular bonds entitled to participate in the foreclosure. They had made some study and investigation of that subject, and, as I understand the matter, had briefed it and since they appeared for the Trustees and had charge of the prosecution of the case I understood that aside from pleadings I would have no responsibility in connection with the depositions or tak-

[14] The reference is to record herein designated as the Foreclosure Record, or "F. R."

ing of testimony until the primary question about the validity of the Mortgage Deed of Trust was determined. Accordingly, I did not assume an active responsibility prior to the Master's report in the above case.

* * * * * *

"I know that there is available a large amount of evidence which was not introduced into the record in the above case which has, in my judgment as a lawyer, a very direct and material bearing on the validity of the bonds secured by the Mortgage Deed of Trust and which is substantial and vital in connection with the bonds held by Phoenix Finance Corporation, and I am thoroughly convinced that the case was not fully tried out on the questions which were actually decided and that there is a large amount of highly important and very material evidence which was never introduced in connection with the bonds of Phoenix Finance Corporation. It is my honest belief and best opinion based upon a large amount of this evidence in my possession that the case would be differently decided if such evidences could be introduced and that through inadvertence, oversight and misunderstanding the result reached in this case has been arrived at without the court getting the benefit of evidence which should be presented in order to do justice between the parties in the aforesaid case."

Although Mr. Sloan's name appears at the opening of hearing before the Master (F. R. 531), he examined no witnesses on direct or cross-examination and made but one objection to evidence (F. R. 637) which in itself bears out the "two stage" contention outlined in Mr. Sloan's affidavit and shows that he was present only in the capacity of an observer at the first procedural stage.

The oral arguments before the Master took place at Sioux City, Iowa, on October 25, 1935 (F. R. 122). The

Master's report lists the attorneys participating (F. R. 122) and it will be noted that no counsel for Phoenix was present. The Report of the Master (F. R. 115 *et seq.*) shows that the only witnesses heard were those of Trustee Complainant, and the Intervener. This report supports the statement that Phoenix introduced no evidence.

Only the Intervener and the Trustees were represented at the taking of the numerous depositions. Phoenix was not represented and no depositions were taken in its behalf. A letter from the Master dated March 9, 1936 stating what his findings and conclusions would be was not sent or addressed to Phoenix or to its counsel.[15] Accordingly even though all the parties and the Master had indulged in an honest procedural mistake with respect to the necessity of any proof of the bonds at the first stage, Phoenix had no way of knowing and in fact did not know, until the Master's report was filed on March 10, 1936 (F. R. 138) that this report would contain purported findings directly affecting Phoenix' status as a creditor or debtor of the Bridge Company.

Obviously if Phoenix had been regarded and treated *as a party* in the hearings before the Master it could have asked for and availed itself of the opportunity to offer evidence before the report was filed. The record shows that Phoenix had witnesses at the last hearing before the Master ready to present such evidence but, in conformity with the "two-stage" understanding and because the second stage had not arrived, Mr. Fowler, counsel for the Trustee Complainants told the witnesses to go home and return for the second stage hearing (F. R. 258, 280, 355, 368).

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[15] This letter is part of *official* record below in the Foreclosure Cause but not designated to be printed.

Mr. Fowler, the attorney for the Trustee Complainants, did not at any time represent Phoenix Finance Corporation, Phoenix Finance System, Inc., or any other of the Phoenix Companies (F. R. 363), and at the hearing before the Master Mr. Fowler gave specific notice that he did not represent Phoenix (F. R. 669). The understanding as to the non-participation of Phoenix is further borne out by the ruling of the Master fixing time for briefs (F. R. 693). No time is fixed for a brief by Phoenix nor did Phoenix file a brief.

In the Supplemental and Ancillary proceeding the foregoing facts were called to the attention of the court by Phoenix' Answer and Counterclaim (R. 164, 165), in the resistance of Phoenix to the motion of Bridge Company that certain depositions be not taken (R. 240, 241) and in the statements of counsel for Phoenix at the final hearing (R. 277, 278).

THE FINDINGS AND DECREE.

The order of reference to the Special Master (F. R. 107) directed him "to hear all of the *issues* in said cause," "to examine the questions *in issue*," and "to report from said evidence his findings of fact and conclusions of law in respect to all of the *issues* * * * ." (Emphasis supplied.) [16]

The Master found certain of the bonds were validly issued and recommended foreclosure with respect thereto (F. R. 138). Had this recommendation been approved by the District Court the case would normally have proceeded

[16] Both the Master and the District Court in the Foreclosure cause obviously considered the *issues* to be broader than *mortgage foreclosure*. It appears that the petition for intervention was considered as tendering *an issue for cancellation of bonds*, to which the Bridge Company and Phoenix (both Delaware corporations) were the opposing indispensable parties. Even the intervener and his counsel treated the intervention petition as a "Cross-Bill." (F. R. 207, 393.)

to the second stage contemplated by the parties. However, the master made no recommendation with respect to the cancellation of bonds as prayed in the Intervention Petition (F. R. 137-138).

The District Court, partially reversing the Master as to certain bonds, found all bonds to be unenforceable *either by reason of their invalidity or because there were set-offs against the same,* with the exception of bonds of the face value of $15,000. This amount was held not properly to justify a decree of foreclosure. Accordingly foreclosure was denied.

The final decree of December 1, 1936 in the Foreclosure Cause and the scope and legal effect thereof is of principal importance on this writ of certiorari. The pertinent portions of said decree are as follows (F. R. 203-204):

> "That the mortgage bonds in suit were fraudulently issued. That all bonds were without valid consideration, with the exception of the bonds aggregating $15,000 only hereinafter specified. That the bill of the plaintiff be dismissed as to the plaintiff Phoenix Finance Corporation and that the prayers of the bill be denied, except in so far as the decree provides for the protection, of the holders of said $15,000 in bonds. *That foreclosure and sale of the mortgage property be denied.* * * * ." (Emphasis supplied.)

No decree or judgment of any character was entered against Phoenix Finance Corporation with respect to any of the matters now in controversy.[17]

[17] Although both the District Court (F. R. 211) and the C. C. A. (F. R. 1691 *et seq.*) held that Phoenix was but "formal" and "unnecessary" party to the Foreclosure Cause, the costs thereof were assessed jointly against the Trustee Complainants and Phoenix (F. R. 204) (See former Equity Rule 40 providing that nominal parties are entitled to their costs and *Jackson v. Jackson*, 175 Fed. 711, 716 (C. C. A. 4th) to the effect that parties who are not indispensable should not be impleaded and if made parties should be dismissed). The collectibility of these costs against Phoenix or its surety is not here involved but is reserved for determination on an appropriate proceeding.

Upon a petition by Phoenix to modify, vacate and set aside the decree as to it,[15] the District Judge in a supplemental opinion said (F. R. 210-211) 19 Fed. Supp. at p. 141):

> "In such case I am of opinion *that the Trustees were the only indispensable parties plaintiff, had exclusive control of the litigation,* and that the only effect of bringing in Phoenix Finance Corporation was by admissions in testimony to establish the status of that corporation as the holder and owner of about 90% of the bond issue. That so far as jurisdictional considerations are concerned, *that corporation was merely a formal and not an indispensable party.*" (Emphasis supplied.)

The decree of the District Court in the Foreclosure Cause was affirmed on appeal to the Circuit Court of Appeals for the Eighth Circuit by decree of August 11, 1938 (F. R. 1709; opinion, 98 Fed. (2d) 416).

Phoenix' petition for modification (F. R. 216) was denied by the District Court (F. R. 411). One of the objects of that petition was to secure *affirmative relief* to enable Phoenix to litigate against the Bridge Company certain of the matters which are now in suit in Delaware and which were put in controversy by the Supplemental and Ancillary Bill. The Circuit Court affirmed that portion of the order of the District Court refusing such requested modification. The basis for this refusal and affirmance thereof is well stated in the concluding paragraph of the opinion of the Circuit Court (F. R. 1709; 98 Fed. (2d) at p. 429):

[15] In the intervener's resistance to this motion, it was moved in the alternative (F. R. 207) that Phoenix' name be stricken from the record, or that the order making Phoenix a party be vacated, or that the decree of December 1, 1936 be re-entered with the name of Phoenix eliminated. Obviously intervener's counsel recognized the questionable validity of an *adjudication against Phoenix* in the Foreclosure Cause.

"Under these long established principles of equity and the pleadings and proof in this cause, the court did not err in refusing to modify the decree as requested by appellant by granting to complainants *affirmative* relief against the defendant." (Emphasis supplied.)[19]

**The Nature and Status of the Causes of Action Pending in Delaware and Any References in the Findings and Conclusions of the Master and of the District Court in the Foreclosure Cause With Respect Thereto.**

The causes of action hereinafter mentioned are partially set out in the Supplemental and Ancillary Bill. Complete exemplified records of said causes showing the status thereof on the date of final hearing in the District Court, are in evidence in this case as Defendant's Exhibit SC-101, SC-102, SC-103, SC-104 and SC-705 respectively (R. 385, 440, 482, 522 and 546).[20] In the following headings reference is made to the appropriate paragraphs of the Supplemental and Ancillary Bill with the record page thereof, the appropriate exhibit with the record page thereof, and the appropriate paragraphs of the decree of the District Court with respect thereto.

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[19] Phoenix does not question this ruling. It is recognized that in a cause of mortgage foreclosure, to which it was an involuntary "formal" party, in which no issues were framed involving the subject matter of its requested *affirmative* relief, and in which it had not participated as a party, Phoenix had no proper status to secure such relief. Recognizing the validity of this ruling Phoenix sued in the Delaware state courts which have unquestioned jurisdiction of the parties and subject matter.

[20] The Bridge Company also offered *incomplete* copies of these records (SC-1, R. 294; SC-2, R. 301; SC-3, R. 307; SC-4, R. 320; and SC-5, R. 340). Most important of the omissions in the Bridge Company's exhibits are the general appearances of its counsel and its pleas of *res adjudicata,* which raised the same question in the Delaware cases as here. In the one case tried the Delaware Court rejected the defense (14 Atl. 2d 386). Decision on writ of error pending decision in Supreme Court of Delaware. (Argued Jan. 30, 1941.)

THE $3125-$2000 NOTE CASE.[21]
7 (a) (R. 5); SC-101 (R. 385); a. (R. 720).

This is an action at law in the Superior Court of the State of Delaware for New Castle County by Phoenix Finance Corporation against Iowa-Wisconsin Bridge Company upon promissory notes of the latter *given directly to Phoenix Finance Corporation* (1) dated January 20, 1933, in the sum of $3,125 payable on July 20, 1933, and (2) dated December 15, 1932, for $2,000 payable on the 15th day of June, 1933.

To the plaintiff's declaration, the Bridge Company, after causing a general appearance of counsel to be entered, filed among other pleas the plea of *res adjudicata,* and at the trial and in proof thereof relied upon the record in the Foreclosure Cause. Certain other pleas and defenses filed by the Bridge Company (*including the plea of set off*) were abandoned at the trial. The case was tried before two Judges of the Supreme Court of Delaware, sitting in *nisi prius,* without a jury (by stipulation) and thereafter the matter was thoroughly briefed and argued by counsel for the respective parties. The trial was on June 15, 1939 (R. 439), or about three months before the filing of the Supplemental and Ancillary Bill (R. 745).

On March 18, 1940, the Judges of the Superior Court handed down a written opinion in the case which rejected the defendant's plea of *res adjudicata* and ordered the entry of judgment on behalf of Phoenix for the amount of said notes plus interest. The opinion appears in 14 Atl. (2d) 386. *The opinion of the Judges of the Delaware Su-*

[21] In the following analyses of the pending Delaware Cases and the status of the $50,000 mortgage and note, petitioner has set forth all findings in the Foreclosure Cause touching (even remotely) on the subject in issue. *It is emphasized that by so doing Phoenix does not concede that any of such findings are valid adjudications against it entitled to full faith and credit. This is the principal question on this writ of certiorari.*

*perior Court in this case is applicable to all issues raised by the Supplemental and Ancillary Bill below. Writ of Error to the Supreme Court of Delaware was argued on January 30, 1941, and decision is pending.* (See Clerk's Certificate in Appendix.)

It will appear that there is an irreconcilable conflict between the judgment of the Delaware Court and the Decrees of the District and Circuit Courts in the Supplemental and Ancillary Cause. Affirmance by the Supreme Court of Delaware will mean a like conflict between the Circuit Court of Appeals for the Eighth Circuit and the Supreme Court of Delaware. *By the decree of March 23, 1940, in the Supplemental and Ancillary cause Phoenix is commanded to dismiss this action with the other pending cases* (R. 722). *This necessarily requires Phoenix to satisfy this judgment at its own cost.*

With respect to the issues in this Delaware law action the following appear as findings of the Master in the Foreclosure Cause (F. R. 133, 134):

> 10 (i) "That the remaining bonds, approximating $19,000.00 or $20,000.00, were issued to the Phoenix Finance Corporation as security[21a] for a note of $3,125.00 given in part to secure the payment of that amount made by the said Phoenix corporation on behalf of the Bridge Company to pay taxes of the Bridge Company in the State of Wisconsin. That to the extent of the principal of, and interest on, the said note only the said bonds are valid, but to no other extent are these particular bonds valid."

> 10 (k) "That of the bonds above named issued to the Phoenix Finance Corporation to secure the said note of $3,125.00, the amount of bonds not necessary for such security, approximating the sum of

21a. $20,100 of bonds were issued by Bridge Company to Phoenix as collateral only to $17,735.19 of Bridg
Company notes. $17,735.19 made up of $3,125 and $2,000 notes in above suit and $12,110.19 and $500

> $16,975.00 are without consideration, obtained by fraud, and invalid."

The master recommended foreclosure as to $27,125 of bonds, including the $3125 item (F. R. 138). There was no finding of fact by the Master referring to the $2,000 note.

The District Court did not approve the Master's findings 10 (i) and (k) (F. R. 179). The Court, while not denying that said $3,125 note was in itself a valid and subsisting obligation of the Bridge Company to Phoenix, in effect *held and found that there was a set-off or counterclaim of the Bridge Company against Phoenix* in the sum of $14,000 which rendered this note unenforceable (F. R. 193). The reasons therefor are given in the opinion of the District Court in the Foreclosure Cause (F. R. 178). The District Court made no reference to the $2,000 note in its findings or opinion.

THE CHANCERY CASE TO SECURE RE-DELIVERY TO PHOENIX OF 517 SHARES OF BRIDGE COMPANY PREFERRED STOCK.
7 (b) (R. 6); SC-102 (R. 440); b. (R. 720).

This is a bill of complaint in the Court of Chancery of the State of Delaware, in and for New Castle County, wherein Phoenix is the complainant and the Bridge Company is the respondent. The bill alleges that on November 1, 1931, the Bridge Company issued to Phoenix Finance System, Inc., certificate for 517 shares of Class "A" stock fully paid and non-assessable; that on January 1, 1932, Phoenix Finance System, Inc., for a valuable consideration assigned said shares to Phoenix Finance Corporation; that on March 15, 1932, Phoenix Finance Corporation transferred and assigned said shares to the Bridge Company in exchange for the issuance and delivery to it of $60,390.14

principal amount of the Bridge Company's First Mortgage Bonds issued in pursuance of the mortgage deed of trust involved in the Foreclosure Cause.

The bill alleges that the form of this exchange of stock for bonds "was that of a purchase from your orator by said Iowa-Wisconsin Bridge Company of said 517 shares of its Class 'A' stock and the consideration for said purchase was the issuance and delivery unto your orator of the bonds of Iowa-Wisconsin Bridge Company as aforesaid"; and that upon the date the Bridge Company purchased the shares from Phoenix as aforesaid "there was an impairment of the capital of said respondent and by virtue of said attempted purchase and sale the capital of the respondent was further impaired." Accordingly, the bill charges that under Section 19 [22] of the Delaware Corporation Law the sale of said 517 shares of Class A Stock of the Bridge Company to the Bridge Company in consideration of the issuance and delivery by the Bridge Company to Phoenix of its bonds was invalid and void.

The bill further states that the Bridge Company refused to recognize said purchase and sale as having been a valid transaction and refused to recognize said bonds as valid and enforceable obligations; and that following said sale and purchase the Bridge Company did not cancel the stock but issued a new certificate to itself which it holds as treasury stock.[23] By the bill Phoenix makes tender of

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[22] 2051 Sec. 19 of the Revised Code of Delaware, 1935, provides:

"Every corporation organized under this Chapter shall have the power to purchase, hold, sell and transfer shares of its own capital stock; provided that no such corporation shall use its funds or property for the purchase of its own shares of capital stock when such use would cause any impairment of the capital of the corporation; and provided further that shares of its own capital stock belonging to the corporation shall not be voted upon directly or indirectly; and provided, further, that nothing in this Section shall be construed as limiting the exercise of the rights given by Section 27 of this Chapter."

[23] This fact was also established in the Foreclosure Cause (R. 210, F. R. 976, 1269).

$60,390.14 principal amount of the said Bridge Company's First Mortgage Gold Bonds and demands the re-issuance to it of a certificate for 517 shares of Class A stock of the Bridge Company.

The Bridge Company appeared generally by its solicitors and filed an answer which is in effect a defense of *res adjudicata* based upon the record of the proceedings in the Foreclosure Cause. Phoenix thereupon moved for a decree notwithstanding the answer and the matter is pending hearing on this motion in the Court of Chancery. The existing injunction against Phoenix prevents it from moving the case to hearing.

There is nothing in the findings either of the Master or of the District Court in the Foreclosure Cause which denies the right of Phoenix to recover from the Bridge Company these 517 shares of the Class A Stock. In fact the Master found that, upon return of $60,500 of bonds to the Bridge Company, Phoenix should be permitted to receive the return of the 517 shares (F. R. 138).

The Master found that at the time of the exchange of the stock for the bonds there was an impairment of the capital of the Bridge Company in violation of the Delaware Corporation Law that the bonds were illegally issued both for this reason and also because the transaction violated a provision of the Bridge Company's corporate charter (F. R. 129). The District Court, by its approval of certain of the Master's findings (F. R. 179) and by its adoption of certain findings with slight modification of language (F. R. 180, 181, 200, 201) arrived at substantially the same conclusions. The District Judge found all bonds without consideration except $15,000 (F. R. 204). Accordingly, it was held that the 517 shares were no considera-

tion for $60,500 of bonds but there is no finding as to the right of Phoenix to a return of the 517 shares.

In Phoenix' petition for modification of the Foreclosure decree (F. R. 216) it was prayed *inter alia* that "the decree be so modified as to reinvest in petitioner 517 shares of 'A' stock surrendered in exchange for bonds" (F. R. 223). As above stated, this petition was denied by the District Court (F. R. 411). The Circuit Court of Appeals affirmed this ruling as heretofore stated (F. R. 1709; 98 Fed. 2d at p. 429).

Phoenix recognizes that its status in the Foreclosure Cause was such that the court did not have jurisdiction to grant this *affirmative* relief. Therefore it sued in the Delaware Chancery Court, the only court having jurisdiction both of the parties and subject matter. The exclusive jurisdiction of the Delaware Chancery Court in litigation of this character is hereinafter discussed.

THE $12,110.19-$500 NOTE CASE.

7 (c) (R. 66); SC-103 (R. 482); c. (R. 720).

This is an action at law in the Superior Court of the State of Delaware for New Castle County by Phoenix against the Bridge Company. It is based upon two promissory notes of the Bridge Company given directly to Phoenix, (1) dated July 7, 1933, in the sum of $12,110.19 payable on demand, and (2) dated December 31, 1932, in the sum of $500 payable on the 31st day of June, 1933. The Bridge Company appeared generally by its attorneys and filed certain pleas including the plea of *res adjudicata* based upon the record in the Foreclosure Cause. The case was at issue and ready for trial in the Superior Court at the time the temporary injunction against Phoenix was issued. From that time Phoenix has been prevented by

the order of the District Court below from bringing the case on for trial.

There is no finding or conclusion either of the Master or of the District Court in the Foreclosure Cause which is specifically and directly referable to the two notes for $12,110.19 and $500 respectively, for which Phoenix is suing the Bridge Company in Delaware in this action.

THE ACTION IN COVENANT ON THE INDEMNITY AGREEMENT. 7 (d) (R. 7); SC-104 (R. 522); d. (R. 721).

This is an action in covenant upon a sealed instrument by Phoenix against the Bridge Company in the Superior Court of Delaware for New Castle County. It is based upon a three party agreement (R. 540) dated November 10, 1930 wherein Phoenix Finance System, Inc., John W. Shaffer & Company and Iowa-Wisconsin Bridge Company are the parties.[24] By this agreement, the Bridge Company covenanted that in the event Shaffer & Company failed to pay and discharge its obligations and in the event Phoenix Finance System, Inc. was required to advance any sums of money by reason of any endorsement or guarantee in connection with the financing of the Black Hawk Bridge that it would pay to Phoenix Finance System, Inc. on demand a sum equal to the total amount due to first party (Phoenix Finance System, Inc.) from all causes in connection with said financing of said Bridge.

The declaration states that John W. Shaffer & Company failed to pay and discharge its obligations to materialmen; that Phoenix Finance System, Inc. thereupon and in pursuance of its obligations under the contract advanced to the Bridge Company for the express purpose of paying

[24] This contract appears as an exhibit in the Foreclosure Cause (F. R. 1393, *et seq.*).

said obligations sums aggregating $21,262.17; that said sums were used by the Bridge Company for the purpose of paying its obligations to the materialmen and that the Bridge Company thereupon became obligated to repay Phoenix Finance System, Inc. the sums so advanced. The declaration further alleges that on January 1, 1932 Phoenix Finance System, Inc. sold and assigned its interest in this contract to Phoenix Finance Corporation. Wherefore the plaintiff claims that the Bridge Company as the defendant in said action has breached the covenants of said agreement and that Phoenix as the plaintiff has been damaged thereby.

In this case also, the Bridge Company entered a general appearance and filed pleas including the plea of *res adjudicata* based upon the record in the Foreclosure Cause. The case was at issue awaiting trial when the injunction of the District Court prevented Phoenix from proceeding further.

While this cause of action is in covenant for damages for breach of the finance agreement of November 10, 1930 above referred to, it is nevertheless, with respect to the damages claimed, predicated upon two advances made by Phoenix Finance System, Inc. to the Bridge Company in cash and bonds of the United States in the sums of $10,000 and $11,262.71. These items are not identifiable in the Master's findings of fact in the Foreclosure Cause. However, in supplemental finding of fact 40 of the District Court in said cause (F. R. 201) appears the following:

> "That on March 7, 1932, a meeting of the board of directors of the Bridge Company was held at which were present Emory H. English, John A. Thompson, M. K. Thompson, Oscar R. Thorson, H. T. Wagner and A. B. Wilder, all Thompson and Phoenix Finance

System, Inc. controlled directors, at which a purported resolution was adopted for the delivery of $97,000 of Class A bonds of the Bridge Company to the Phoenix Finance System, Inc., for the purported $50,000 mortgage and interest thereon and for $10,000 to the Industrial Contracting Company, $9,000 to Kramer & Hogg and $11,262.71 to McClintic-Marshall Company, with interest on such items amounting to $83,811.29 and with discount on the bonds of $12,727.31, making a purported total of $96,538.58 and a purported balance of $461.42 being charged to Phoenix Finance System, Inc., on the books of the Bridge Company, making a total of $97,000.

The aforesaid $10,000 to the Industrial Contracting Company was neither due from nor paid by the Bridge Company as aforesaid and the Bridge Company did not owe the $11,262.71 to McClintic-Marshall Company. That said two items were items that had been fully covered and disposed of by the Bridge Company in its settlement with John W. Shaffer & Company and were items which Thompson & Company, subsidiary of Phoenix Finance System, Inc., had undertaken to pay. That as a part of the scheme, plan and conspiracy leading up to the issuance of said bonds here involved, the said Thompson paid the balance of $11,262.71 to McClintic-Marshall Company and as a form and pretense the said John A. Thompson, dominating and controlling the Bridge Company in its act, in making payment thereof for the Phoenix Finance System, Inc., as aforesaid, attempted to carry out such transaction as though he was making payment thereof for the Bridge Company and caused false entries to be made on the books of the Bridge Company as though said approximate amount had been advanced by the Phoenix Finance System, Inc., to the Bridge Company and the item paid by the Bridge Company, when in fact the Bridge Company did not owe said item."

The District Court also found that on August 6, 1931 Shaffer & Company owed Industrial Contracting Company $10,000 and McClintic-Marshall Company $11,262.71; that as of this date a settlement agreement was entered into between the parties by which the Bridge Company transferred to Shaffer & Company and its associates certain shares of stock; that Shaffer & Company turned over to Thompson of Thompson & Co. (a subsidiary of Phoenix Finance System, Inc.) 100 shares of those so received, and that Thompson & Co. thereupon agreed to pay the Industrial Contracting and McClintic-Marshall items (F. R. 194, 195). This may be construed as a finding that the Bridge Company was thereby relieved of its liability to pay these items.

At another point the District Judge found that Phoenix Finance System, Inc., paid Industrial Contracting Company $10,000 but that Thompson caused entries to be made in the books of the Bridge Company as though System had advanced the $10,000 to the Bridge Company (F. R. 196). Finally, the District Court held that all of the bonds were without valid consideration except $15,000 (F. R. 204). This holding, of course, applied to the bonds issued by the Bridge Company to Phoenix in settlement of or as security for these two items.

Neither of the items of $10,000 and $11,262.71 was attacked in any pleading. There was no claim that these funds were not received or used by the Bridge Company. There was no issue that Shaffer & Company and not the Bridge Company owed these bills and such issue could not have been adjudicated without Shaffer and Company being present as an indispensable party.

The Action in Debt on Two $500 Bonds.
7 (e) (R. 7); SC-105 (R. 546); e. (R. 721).

This is an action at law in the Superior Court of the State of Delaware for New Castle County by Phoenix against the Bridge Company. The action is in debt and is based upon the obligations of the Bridge Company under two $500 first mortgage gold bonds Nos. 73 and 97 respectively. The declaration shows the breach by the Bridge Company of the terms and conditions of said writings obligatory and the plaintiff as the present owner and holder thereof (said bonds being negotiable and unregistered) claims the amount of said bonds ($1000) plus lawful interest.

The Bridge Company has appeared generally by its attorneys and filed pleas including the plea of *res adjudicata* raising the issue of the scope and effect of the record in the Foreclosure Cause. The case is at issue and awaiting trial when the injunction is lifted.

This cause of action is merely an action in debt on two $500 bonds. By paragraph 7 (e) of the answer and counterclaim of Phoenix (R. 150) it is admitted that said bonds were a part of the bonds originally issued to Helmer Anderson (not a party to foreclosure cause) by the Bridge Company in the total amount of $7,400. By stricken paragraph 13 of the Answer and Counterclaim of Phoenix (R. 151) it was alleged by Phoenix that Anderson sold all of said $7,400 of bonds for valuable considerations to various persons and that thereafter and prior to the decree in the Foreclosure Cause, Phoenix purchased the two bonds upon which this action is based, and it is the contention of Phoenix that its right to recover upon these bonds was or could not have been adjudicated by the decree of December 1, 1936, in the

Foreclosure Cause. The Master in the Foreclosure Cause by finding of fact 10 (b) (F. R. 132, 133) held as follows:

> "That of the remaining bonds $7,400 there were issued to Helmer Anderson for the consideration to the Bridge Company of $6,000, in consideration of the purchase of a leasehold and other interest in real estate belonging to the Bridge Company. So, to the extent only of said $6,000 did the Bridge Company receive consideration in this transaction."

This finding was approved by the District Court (F. R. 182). At no point in the record of the Foreclosure Cause does it appear that any of the then holders or owners of any of the so-called Helmer Anderson bonds were in any manner before the District Court in the Foreclosure Cause for the adjudication of their respective rights as innocent purchasers. It is to be observed that the $7,400 of bonds were given to Anderson in consideration for land purchased by Anderson's assignor from the Bridge Company for $6,000 plus gasoline station equipment and improvements added by Anderson after the acquisition of the land. Obviously, therefore, the District Court in this particular proceeded arbitrarily, without pleading, contention or issue, to approve the bonds to the extent of $6,000 and no more. Anderson was not in court actually or by representation. He had sold land and improvements to the Bridge Company for $7,400 and had received bonds in the face amount in payment. Later Phoenix acquired for value two $500 bonds of this issue (R. 207). There was no fraud alleged, proved or found with respect to this transaction.[25]

[25] The foregoing recitals deal with 4 law and 1 equity actions in the Delaware Courts. The 5th law action referred to in the Supplemental and Ancillary Bill (R. 7, par. 7 (f)), the "Bridge Toll Ticket Case", was withdrawn from consideration at final hearing by counsel for the Bridge Company (R. 475). However, Bridge Company counsel designated this record to be printed (R. 737, par. 5) as a part of affidavit for preliminary injunction and the same is printed in this record (R. 107-118).

**The $50,000 [26] Mortgage and Any References in the Findings and Conclusions of the Master and of the District Court in the Foreclosure Cause With Respect Thereto.**

Paragraph 11 of the Supplemental and Ancillary Bill (R. 10) deals with a mortgage in the sum of $50,000 dated March 10, 1931, given by the Bridge Company to Phoenix Finance System, Inc., and recorded in Allamakee County, Iowa. Copies of this mortgage are in evidence in this cause as Complainant's Exhibits SC-6 and SC-7 (R. 374, 379) and it appears thereby that the mortgage is of record in Crawford County, Wisconsin, as well as Allamakee County, Iowa, in the name of Phoenix Finance System, Inc. It is admitted that the petitioner is the successor in interest of Phoenix Finance System, Inc., with respect to this mortgage and the note secured thereby. John A. Thompson if he had been permitted would have testified both on deposition and at final hearing (R. 208, 278) with respect to this mortgage. Such testimony was corroborated by that of Albert Penn, President of Phoenix Finance Corporation (R. 198, 290). The portion of the Answer and Counterclaim of Phoenix (R. 156) stricken by order of the District Court (R. 171) states the essential facts with respect thereto.

On March 10, 1931, Phoenix Finance System, Inc., loaned to the Bridge Company $35,000 in order to enable the latter to pay an indebtedness to the contractor in connection with the building of the Black Hawk Bridge. The indebtedness so paid constituted a lien upon the bridge property. At the same time Phoenix Finance System, Inc., loaned the Bridge Company the further sum of $15,000

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[26] This is an "open mortgage" providing for further anticipated financing beyond the $50,000, and by reason of certain further advances, including $9,000 to pay certain liens, is now at least $59,000. It is not to be confused with the $200,000 mortgage deed of trust in suit in the Mortgage Foreclosure Cause.

which was placed to the credit of the Bridge Company with Thompson & Co., its then acting fiscal agent (F. R. 340). By July 13, 1931, this entire credit and all other credits in favor of the Bridge Company had been paid over to the latter by Thompson & Co. (R. 157; see also F. R. 1127).

The loans so made by Phoenix Finance System, Inc., were evidenced by a promissory note of the Bridge Company in the amount of $50,000 payable to the order of Phoenix Finance System, Inc., which said note was secured by a mortgage on all the property of the Bridge Company. This is the mortgage in controversy. The mortgage was authorized by the board of directors of the Bridge Company and ratified by its stockholders. It was executed and delivered as of March 10, 1931. Emphasis is placed upon the following provision of said mortgage (R. 376):

> "And the said Iowa-Wisconsin Bridge Company further agrees that the said Phoenix Finance System, Inc., at any time during the existence of this indebtedness, or any part thereof, and until the same is fully paid, shall have full power and is hereby authorized as attorney-in-fact for said Iowa-Wisconsin Bridge Company to pay all liens of any kind, whether prior or subsequent, that may in any manner affect the title to the lands, buildings, structures, toll bridge and appurtenances herein and hereby conveyed, and for the repayment of all moneys so paid, together with interest thereon at the rate of eight per cent per annum, payable semi-annually, this indenture shall be like security, in like manner, and with like effect as for the payment of said note."

On November 10, 1931, Phoenix Finance System, Inc., loaned to the Bridge Company the further sum of $9,000 in reliance upon the above clause of the mortgage. The

loan was made and used for the purpose of paying the Bridge Company's indebtedness to Kramer & Hog, a contractor, for grading work on the bridge project, which indebtedness constituted a lien on the bridge property for which the Bridge Company was liable (R. 158, 208). Both the Master and the District Court found that "the Bridge Company received full consideration for the said $9,000 thereof issued to Kramer & Hogg in settlement of a mechanics' lien claim." (F. R. 132, 182). It will thus be seen that the security of this mortgage is not limited to the original consideration of $50,000.

The items of $15,000 and $35,000 respectively which form the basic consideration for this mortgage are supported and verified by the report of the special examination of the receipts and disbursements of the Bridge Company as made by Ernst & Ernst, Auditors and Accountants, under date of January 17, 1940 (R. 595-693 at 611). This report is an exhibit to the resistance of Phoenix to the motions of the Bridge Company that certain depositions be not taken (R. 223), and at the final hearing was offered in evidence as Defendant's Exhibit SC-114 (R. 292, 595). The tendered testimony of Preuss (R. 217), Thompson (R. 205) and Penn (R. 197) verified the accuracy of said report. There is no contradictory evidence in either record. The $15,000 and $35,000 loan items are evidenced by a promissory note for $50,000 secured by the mortgage in question. At no point in the pleadings, evidence, findings, conclusions, opinions, orders or decrees in the Foreclosure Cause is to be found any reference to this $50,000 note. Neither the note nor a copy thereof was called for or introduced or even described in evidence in the Foreclosure Cause.

This note, by the decree in the cause below, is ordered delivered to the Clerk of the District Court for cancellation (R. 722), and pursuant to the stay order of April 8, 1940 (R. 725) has been delivered to the Clerk of the District Court to be impounded pending appellate proceedings. Until this was done, the Court had at no time or in any manner been advised by pleading or evidence as to any of the terms and conditions of the note, including interest or maturity.

With respect to the $50,000 mortgage, the consideration therefor as represented by the two loans of $15,000 and $35,000 respectively, and the subsequent item of $9,000 above referred to, the Master in the Foreclosure Cause held that there was no consideration except with respect to the $9,000 item (F. R. 132). The District Court by supplemental finding of fact 26 (F. R. 192) found that the Bridge Company received no consideration for the execution of said mortgage and "that the same was and is wholly without consideration, fraudulent and void." With respect to the advances totalling $50,000 and forming the consideration for said mortgage as originally issued, the District Court by the same finding found that "no part thereof was received by the Bridge Company."

The District Court did not disapprove of the Master's finding with respect to the validity of said $9,000 item. The Court took the same position with respect thereto as with respect to the $3,125 note above mentioned, viz., that the Bridge Company had a counterclaim or set-off against Phoenix in the sum of $14,000 which more than covered these two items. It is to be noted that no set-off or counterclaim is asserted by pleading. Even if this issue had been raised, it would have involved solely a controversy between

two Delaware corporations as opposing parties. It was in no way an ancillary issue in the Foreclosure Cause.

There was no pleading in the foreclosure case asking for surrender and cancellation of this $50,000 note or mortgage nor could such issues be heard even if pleaded without Phoenix being present as an indispensable party. With Phoenix present as such party, no Federal jurisdiction would have existed as hereinafter shown.

**The Pleadings and Evidence to Support the Defense and Counterclaim That the Bridge Company Had Failed to "Do Equity," Was in Court With "Unclean Hands," and That There Was Fraud Inherent in the Decree of December 1, 1936, in the Foreclosure Cause.[26a]**

*As hereinafter shown, it is the primary contention of the petitioner that there was no valid adjudication in the Foreclosure Cause except the bare issue of foreclosure and that there were no valid adjudications against Phoenix with respect to any of the matters raised by the supplemental and ancillary bill.*

It is an alternative contention of the petitioner (assuming *arguendo* the existence of such valid adjudications against Phoenix) that in a court of equity, where a party is seeking supplemental relief in aid of a decree in its favor, the Court should, on the basis of the equitable maxim that "he who seeks equity must do equity," and particularly where fraud and misrepresentation on the part of the prevailing party or its counsel is set up as a part of the defense to the ancillary relief, not only require the moving

[26a] A consideration of the facts under this heading is not necessary if the court shall agree with petitioner's primary contention, *viz.*, that the decree of December 1, 1936, in the Foreclosure Cause contains no adjudication against it with respect to the issues of the Supplemental and Ancillary Bill.

party to show that the decree sought to be implemented was a "right" one, but should permit the defendant to the supplemental bill to show the lack of equity in the complainant and to prove the fraud alleged, and, if the charges are sustained, to refuse affirmative relief or to revise, modify or set aside its decree in the interest of justice. The facts so showing inequity and unclean hands on the part of the Bridge Company and the circumstances of fraud inherent in the decree of December 1, 1936, in the Foreclosure Cause are set forth in those portions of the answer and counterclaim of Phoenix stricken by order of the court below (R. 171, 151-167).

It would, perhaps, be sufficient to raise the point, for the petitioner to rely solely upon the District Court's action in striking the answer. The point is raised again, however, on the District Court's refusal to permit petitioner to take the depositions of Skoner, Preuss and Gage (R. 223) and of Thompson and Penn (R. 256).

The point is presented finally in the refusal of the District Court to permit the petitioner to offer testimony and exhibits at the final hearing (R. 286-292). Such evidence related not only to what were conceived to be relevant issues raised by the pleadings but also to lack of equity on the part of complainant and certain of the circumstances of fraud and misrepresentation as to the record which are inherent in the decree of December 1, 1936.

The facts so alleged and stricken and so offered and rejected may be summarized as follows:

(1) The petitioner contends that the Bridge Company may not maintain its Supplemental and Ancillary Bill because it has not done or offered to "do equity," and because it comes into Court with "unclean hands." Basically,

this is because the Bridge Company has not restored or offered to restore to Phoenix the *bona fide* considerations paid and advanced to it by Phoenix and its predecessor in interest. Proof of the supporting facts was offered by the depositions of Thompson (R. 205), Penn (R. 197), Skoner (R. 221), Preuss (R. 217), and Gage (R. 218), and the tendered testimony in person at the final hearing of Thompson (R. 276-286), Penn (R. 290), English (R. 291), and Skoner (R. 291). The principal item of proof of the outstanding indebtedness of the Bridge Company to Phoenix is, however, defendant's exhibit SC-114 (R. 595-693) supported by the offered testimony of the above named witnesses. This exhibit is a comprehensive report of a special examination of the financial affairs of the Bridge Company from November 1, 1930 (a date prior to first transaction involved therein) to September 25, 1933 (date of receivership), made by Ernst & Ernst, Accountants and Auditors, of Chicago.

It is shown by the offered testimony of Lee J. Skoner (R. 221-222), and of George E. Preuss (R. 218) that these witnesses:

> "examined the original cancelled checks representing all of the cash disbursements by check referred to in the report (excepting only checks for $1,994.37), examined all of the original bank statements or original records of the banks upon which such checks were drawn or in which the same were deposited and all of the cash deposits and withdrawals recorded on the books of the Bridge Company."

Accordingly this report is in no respects a "*petitio principii*", a characterization given by the District Court to another auditor's report presented in the Foreclosure Cause (F. R. 177).

The report shows that the Bridge Company received in cash from Phoenix (including Phoenix Finance Corporation and all predecessors in interest) $318,141.85 and repaid only $213,402.87, leaving an indebtedness of the Bridge Company to Phoenix of $104,738.98, which, less net credit for non-cash items of $6,389.52, leaves a balance of net cash justly due from the Bridge Company to Phoenix, exclusive of interest and exclusive of other stock and toll ticket investments or claims, of $98,349.46 (R. 598). On this indebtedness the report shows there had accrued as of December 31, 1939, legal interest in the *net* amount of $55,638.95. Accordingly, on the basis of said report and investigation so made, verified and certified, there is due to Phoenix from the Bridge Company a just debt totalling $153,988.41 (R. 603). *All of the claims in litigation in Delaware (excepting the Chancery case for the return of the 517 shares of "A" preferred stock and the Bridge Toll Ticket case) refer to parcels of this indebtedness. The underlying indebtedness of at least $59,000 for which the aforesaid mortgage is security is also parcel thereof.*

In proper courts in which it is an indispensable party and in which the Bridge Company has available and has, in fact, asserted all claimed defenses, Phoenix is attempting to recover this just indebtedness and thereby to have the day or days in court heretofore denied it.

(2) The litigation in the District Court in the Foreclosure Cause was in "exclusive control" of counsel for the complainant trustees (F. R. 211). Counsel and all parties throughout the proceedings acted under the belief and assumption that the only issues before the Master were the validity of the deed of trust, the existence of a default and the right to a foreclosure and, that any question as to

the validity of the bonds that might then be challenged, or, as to the consideration received by the Bridge Company therefor, was reserved for determination at a second stage of the proceeding. The facts justifying such belief and assumption are stated in the stricken 40th paragraph of the Answer and Counterclaim of Phoenix (R. 164) as follows:[27]

> "As to said matters, Phoenix has not had its day in court. Counsel for complainant Trustees in the foreclosure proceedings had complete charge of the litigation, as this Court found by its order of January 5, 1937. Said counsel acted throughout the proceedings under the belief that the only issues before the Master to whom said cause had been referred were the validity of the deed of trust, the existence of a default and the right to a foreclosure, and that any question as to the validity of the bonds or the consideration received by the Bridge Company therefor was reserved for determination at a second stage of the proceedings. This belief was founded in part upon the prevailing practice with respect to foreclosure proceedings in the United States courts and in part upon the apparent ruling of the Master that such would be the procedure before him. In the said proceedings before the Master and on exceptions to the Master's report and at other times in the proceedings, counsel for the Bridge Company repeatedly asserted and represented that the indebtedness of the Bridge Company to any bondholder was not in issue and could not be adjudicated in such foreclosure proceedings. Relying upon such representations and their belief as to the procedure to be followed, the Trustees offered substantially no evidence on their *prima facie* case on the foreclosure proceedings with respect to the consideration for any of the

[27] The facts as established by the record in the Foreclosure Cause have been heretofore further stated in a footnote under a former heading of this Statement p. 15, *supra*).

bonds, and the proofs offered in their behalf were merely the *prima facie* proofs in a foreclosure proceeding. Almost no cross-examination was attempted of the various witnesses called by the Bridge Company and the interveners in said cause and no evidence whatever was offered in rebuttal of the testimony of such witnesses, and counsel for the Trustees notified many prospective witnesses that their testimony would be required at a later stage of the proceedings.''

At the final hearing in this cause, Phoenix offered to prove that at the hearing before the Master in the Foreclosure Cause it was at all times ready, willing and desirous of presenting evidence on its behalf; that it had witnesses physically present on one or more days; that counsel for the Trustee Complainants, who was in charge of the trial, stated that such presentation and evidence by Phoenix was not necessary at that stage of the proceeding; and that Phoenix accordingly dismissed its witnesses and offered no evidence on its behalf (R. 277, 278). See also F. R. 217-222, 224, 226, 230, 258, 280-282, 363, 368.

The above facts constitute the background upon and by means of which the claimed fraud was perpetrated.

(3) The District Court in the Foreclosure Cause denied a petition for modification of decree filed by Phoenix in an effort to correct the results of the procedural assumption above stated and to enable it to present its evidence with respect to the uncontemplated issues decided adversely to it and of which it was apprised for the first time by the Master's report. In this matter the District Court refused to exercise its discretion to reopen the case *on the ground that Phoenix had refused and failed to comply with an order of the court to produce its books and records.* In its opinion denying the motion for rehearing,

the District Court in the Mortgage Foreclosure Cause said (F. R. 413):

> "The interveners obtained an order of court for the production of the books and records of the Phoenix Finance Corporation before the Master, but Phoenix Finance Corporation vigorously and successfully it appears prevented the production of those books and records, and its officer when on the stand before the Master, declared his inability to produce, for they had been sent to the State of Florida. It is now with poor grace that the plaintiffs invoke the discretion of the court for a rehearing in order to use those very books and records. Anticipating an adverse ruling, the petitioners alternatively pray for a modification of the decree with provisions commanding the reissuing of certain shares of stock to Phoenix Finance Corporation, which it cancelled when fraudulently obtaining the bonds. One might conceive some invidious analogies to this situation. Having attempted the strong box of another and being hoist by what is now claimed to be a premature explosion, they volubly invoke the compassion of the Court to restore valuable implements of their craft left behind. I see no reason why a court of equity should be deeply concerned in giving an affirmative relief to the Phoenix Finance Corporation. On the other hand I think the petitions for rehearing should be denied and the motion to dismiss and vacate the decree overruled, and it will be so ordered."

The order of the District Court referred to in the foregoing quotation was dated April 24, 1934, the material portion thereof being as follows (F. R. 98):

> "Ordered that the defendant Phoenix Finance Corporation produce *at its office in Des Moines, Iowa,* all its books and records appertaining to the business and

affairs of the Iowa-Wisconsin Bridge Company, *within ten days from the date of this order* and submit them to the inspection of the Intervener and its counsel and accountant." (Emphasis supplied.)

That part of the application of the intervener requesting the production of Phoenix Finance System, Inc., and Thompson & Co. books (F. R. 92-96; 97-98) was not granted.

Paragraph 43 of the answer and counterclaim of Phoenix (R. 166) with respect to the foregoing states:

> "*The books were duly produced as required by said order and copies of the pertinent entries were furnished to counsel for the intervener and the ruling of the court on the petition for rehearing was solely the result of the deliberate misrepresentation to the court by counsel for the intervener in response to the petition for rehearing that Phoenix had defied the order of the court with respect to such books and papers.*"

These facts are restated in the resistance of Phoenix filed to the motion of the Bridge Company that the depositions of Thompson and Penn be not taken (R. 248-250).

It has been shown that there was at least a misunderstanding between the Master and the attorneys for the respective parties as to the scope of the issues for the decision of the Master at that stage of the proceeding in the Foreclosure Cause. In addition thereto it is significant that even counsel for the interveners and the Bridge Company in the proceedings before the Master and on the exceptions to the Master's report repeatedly asserted and represented *that the indebtedness of the Bridge Company to any bondholder was not in issue and could not be adjudicated in such foreclosure proceedings.*" (R. 165.) [28]

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[28] See paragraph 40, Phoenix Answer and Counterclaim (R. 164). This was a provable allegation and in support thereof the defendant below, if it had been permitted, would have referred to the briefs and transcripts of record in

In view of these facts, it is inconceivable that the District Court upon the basis of the showing made on the petition for modification by Phoenix (F. R. 216, with supporting affidavits and exhibits 224 to 390) would not have granted the requested modification, at least to the extent of permitting Phoenix to offer its evidence and thereby have

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the court below in the Foreclosure Cause. All such briefs and transcripts are a part of the official record in the Foreclosure Cause as filed by the Master (F. R. 138). At the trial of the supplemental and ancillary cause, counsel for the Bridge Company asked the court to judicially notice all the records, papers and files in the cause (R. 260). The proof thus available is as follows: Counsel for interveners in brief filed with Master about August 26, 1935 at page 145 asserted that if any bondholder had a claim he might sue at law. At the Sioux City oral argument on October 25, 1935, counsel for the interveners said that if "good faith creditors" took bonds, that did not make them "good faith" bondholders but that "they still have their claim against the corporation," and that "if this bond issue is knocked out * * * they are in no worse position than they were before * * * they are just like the man who took a note for a debt." At the same hearing (p. 147 Sioux City transcript), counsel for the Bridge Company said:

> "Now then supposing that this court says that the bond issue is entirely void, either for fraud or if it is ultra vires, is the Phoenix Finance Company going to be hurt, Phoenix Finance Corporation? They still have a remedy. If they have a legitimate claim they can still file that with the the Iowa-Wisconsin Bridge Company, and if the Iowa-Wisconsin Bridge Company is convinced that it is a fair claim they will be dealt with fairly. On the other hand if they are not convinced that it is fair the claim will be denied and they have their remedy in a court of law to try to enforce a general creditor's claim. They still have their right."

Again, this same counsel said (p. 150, Sioux City transcript):

> "But I believe that instead of throwing out only this one matter that this entire bond issue should go out, and any man or any corporation that has a legitimate claim against the Iowa-Wisconsin Bridge Company let him file it in due course and let him get what he is entitled to. I don't believe there is anything in the record of this corporation that shows that there was ever any intention of depriving one just creditor out of a dime. I don't believe any court would allow the Iowa-Wisconsin Bridge Company to defeat a man of a just claim."

At the same hearing, counsel for the intervener further stated (p. 87, Sioux City transcript):

> "* * * a matter that is tainted with fraud cannot stay in court, that the court will throw such a thing out of this court, it will relegate it to go back and to present its claims to a court of law, if it has any claims, and that is the situation here. If there is anybody there that is holding any bonds they can present them to a court of law and if they have legitimate claims they will be fairly dealt with."

Again, counsel for interveners in their brief filed with the District Judge on exceptions to the Master's report, used language identical in effect with the foregoing and restated (p. 20) "that if any bondholder has a legitimate claim, he may sue at law." At the Dubuque hearing on February 17, 1937, counsel also asserted that the $50,000 mortgage could not possibly be adjudicated in the Foreclosure Cause and that any right of Phoenix to the 517 shares of stock was a matter for the state courts to pass upon.

its day in court. It appears, however, with such moral certainty as is possible in such a case, that the discretion of the District Court was moved to deny the petition for modification of the decree and to reopen the case *solely* by reason of the false representations made by counsel for the interveners to the effect that Phoenix had refused to produce certain books and records as ordered. *There was nothing in the record to support this charge and, in fact, the charge is definitely disproved by the record itself.*

Thus on December 4, 1934, seven months *after* the order to produce, the intervener moved to strike the answer of Phoenix "on the ground that the said Phoenix Finance Corporation has wilfully disobeyed and refused to comply with the rules and order of this court for the production of books and papers * * *." (F. R. 106.) *The motion was overruled* and intervener excepted thereto (F. R. 108).

The statement that Phoenix had refused to obey the order for the production of its books was made so repeatedly by counsel for the intervener in briefs and oral arguments that finally the *mere statement* of the fact insinuated itself upon the court's mind *as a fact.* Not only were the required books and records of Phoenix produced *at its office in Des Moines* and kept available there *for more than the required ten days,* but copies of the required portions were supplied to counsel for interveners and officers and attorneys of Phoenix on many occasions told counsel for the intervener that the books were available for his use. He never availed himself of them.

The hearings before the Master were commenced in Des Moines, Iowa, on July 15, 1935 (F. R. 115) or nearly fifteen months after the order for production had expired by its term. There was no request or order for the production of books *at this hearing* or at the later reconvened hear-

ing in Mason City, Iowa. The order called for *only the records pertaining to the business of the Bridge Company* and it required those limited records to be produced at the Phoenix' Des Moines office only.

Phoenix did not, as heretofore shown, participate at said hearings but certain of its officers or former officers were examined orally and by deposition, one as witness on behalf of the Trustee Complainants, and the others on behalf of the Intervener. Although Emory H. English, a former Vice President of Phoenix, was present in person at certain of the hearings before the Master, he was not examined. Instead his deposition taken on November 27, 1934 (F. R. 613) was used. In this deposition, Mr. English stated that his entire activities were in the "loan offices" (F. R. 614) of certain loan corporations. Mr. English testified that the only account he had any connection with was the expense account in the Iowa-Des Moines National Bank (F. R. 614) and that the minute book and records of Phoenix Finance Corporation "bearing on the matter of succession of Phoenix Finance Corporation to the holding of the bonds" were (at that time, viz., November 27, 1934, or six months after said order expired) "all in the hands of the President and Secretary, not in my possession or under my control." (F. R. 615.)

John A. Thompson, President of Phoenix Finance Corporation, was called as a witness on behalf of interveners (F. R. 545) in July, 1935. He was interrogated at that time concerning books of *Phoenix Finance System, Inc.* and with respect thereto he said (F. R. 550):

> "I have no charge of the records of the Phoenix Finance System at this time. They are not in my custody or control."

The deposition of John A. Thompson (F. R. 414 *et seq.*) was also taken on behalf of the intervener but *it was never offered in evidence.* This deposition was taken *after* the required ten-day period. Mr. Thompson was interrogated about books of Phoenix Finance System, Inc. (not the books ordered), and with respect thereto, said (F. R. 470):

> "It would hardly be within my power or authority to produce the books of a corporation of which I am neither a stockholder or an officer or director. The proper channel for the production of that book is open to you and has always been open."

Mr. Thompson's deposition was taken between May 10, 1934 and August of the same year. The only Phoenix Finance Corporation record he was asked about was the minute book. He said that the minute book *at that time* (i. e., after the expiration of the order for production) was in St. Petersburg, Florida (F. R. 436) but, although not ordered to produce it at that time or at any time, Mr. Thompson voluntarily offered to have it sent from St. Petersburg to intervener's counsel "as quickly as the mails can bring it." (F. R. 476.) No further request for the book was made.

There is nothing in the depositions of Emory H. English or John A. Thompson or in the testimony of John A. Thompson nor is there anything elsewhere in the record which proves a violation of the order of April 24, 1934 to produce *at the office of Phoenix Finance Corporation in Des Moines within ten days thereafter* the books and records of that company "appertaining to the business and affairs" of the Bridge Company.

(4) The facts which Phoenix was in a position to prove at the anticipated second stage are fully stated in para-

graphs 17 to 38 inclusive of the Answer and Counterclaim of Phoenix (R. 153-164). All of these allegations were stricken by order of the District Court (R. 171). With respect thereto, it is stated in stricken paragraph 39 of the Answer and Counterclaim of Phoenix (R. 164):

> "To the extent that the findings of this court as entered December 1, 1936 and its decree are inconsistent with the foregoing allegation, the said findings and decree are contrary to the facts and are the result of the tactics of the interveners and their counsel in the trial of the foreclosure proceedings, first, in presenting to this court a voluminous record consisting largely of testimony and exhibits relating to immaterial and irrelevant issues, so ambiguous and disorderly as to make it difficult, if not impossible, for the court to ascertain the facts and to compel the court to rely upon the representations of counsel, and second, in making false representations or inadvertent representations, particularly with respect to the relationship between John A. Thompson and Shaffer prior to November 1, 1930, the status of the completion of the bridge project at November 1, 1930, the fact that the 3200 shares of stock and $10,000 paid to Shaffer & Co. under the superstructure contract did not cover or purport to cover extras under that contract nor pay for the completion of the bridge project, the fact that the Bridge Company was indebted to Shaffer & Co. on March 10, 1931 far in excess of $35,000 and the fact that the loans to the Bridge Company by Phoenix Finance System, Inc. in September and December, 1931, were for the purpose of enabling it to make payment to Industrial Contracting Company and McClintic-Marshall Company for extras under said superstructure contract for which the Bridge Company was liable under said contract. By reason thereof the said findings and decree are contrary to the facts in other respects, not herein specified."

The petitioner recognizes that as a general rule errors are reviewable only on appeal. However this is a *Supplemental Proceeding* and the party seeking *supplemental* relief is required to show that the former decree was a "right" one. The defendant can challenge that former decree as "wrong." As one part of its proof, petitioner, as the defendant in the *Supplemental Proceeding* below takes the position that the misrepresentations of counsel for the intervener as to what the record contained, made to the Master and to the District Court upon oral argument and upon briefs led the District Court into finding facts not only unsupported by the record, but in many instances definitely disproved by the record. The voluminous character of the record renders understandable how the court could thus be imposed upon.

A discussion as to what those facts are specifically and what detailed evidence is available to prove or disprove the same has no place on this writ of certorari.[29] *The point*

[29] As an outstanding example of a vital "wrong" finding of fact in the Foreclosure Cause sought to be challenged by the defendant in the Supplemental and Ancillary Cause is the following statement by the District Court in its opinion relating to findings of fact on the same subject (R. 169):

> "Suffice to say that from that time on [Nov. 1, 1930] until shortly before the suit was commenced, J. A. Thompson and other officers of Phoenix Finance System, Inc. and other employees of that company controlled completely the Iowa-Wisconsin Bridge Company * * *."

The finding of the Master on this point is substantially the same (F. R. 135).

Such fact does not appear from the Foreclosure Record and *such is not the fact*. Phoenix' evidence in support of its defense to the Supplemental and Ancillary Bill would have been in conformity with the allegations of its answer and cross-bill in this respect. Here is a fact underlying the decree of December 1, 1936 in the Foreclosure Cause which contributed materially to the result. It was not "right" and the petitioner as defendant to a supplemental bill seeking to implement a "wrong" decree was entitled to show the true facts. Briefly stated, the correct factual situation in this regard is as follows:

The only stockholders' meetings of the Bridge Company during the period in question were on Nov. 11, 1930, Nov. 26, 1930, March 10, 1931, Dec. 22, 1931, March 8, 1932 (F. R. 861 *et seq.*). At the time of the November, 1930 meetings, Phoenix Finance System, Inc. and all individuals identified with it in any way, including J. A. Thompson, owned only 3% of the total outstanding voting stock of the Bridge Company (F. R. 311) but not a single share of this stock holding was voted (F. R. 861, 880). At the March 10, 1931 meeting, 36.7%, the December 22, 1931 meeting, 18.5%, and the March 8, 1932 meeting, 22.6% was so owned (F. R. 311, 1299).

There were eleven members of the board of directors of the Bridge Company during the period in question. At no time during that period did more

*is that under "Lord Redesdale's Rule," the defendant in the Supplemental and Ancillary Cause should have been permitted to show that the decree of December 1, 1936 was not "right."*

Because the Bridge Company has not "done equity" and because fraud is charged as being inherent in the decree of December 1, 1936 in the Foreclosure Cause, the petitioner says that on this Supplemental and Ancillary Bill seeking to implement that decree, the District Court below should have scrutinized its records and modified that decree, or, at least, have permitted Phoenix to offer its evidence.

(5) At the final hearing on the Supplemental and Ancillary bill, Phoenix tendered evidence in connection with the foregoing. All such evidence was rejected (R. 286-292). At the final hearing, counsel for Phoenix in making tender of testimony and exhibits also made a comprehensive statement as to the exact nature and relevancy of the evidence offered. *In this respect, the attention of the court is directed to the statements of counsel, the colloquies between court and counsel and the rulings of the court below appearing at pages 272 to 292 of the record.*

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than four directors participating in any meeting have any connection whatsoever with Phoenix Finance Corporation or with Phoenix Finance System, Inc. During the critical period November 1, 1930 to November 1, 1931, never more than two of the directors participating in any meeting were identified with any Phoenix corporation. *At no time during the entire period* were there more than five out of eleven directors *entitled* to participate at meetings (if the same had been held) who had any identity with the Phoenix corporations. (F. R. 861 *et seq.*, 230-254, 257, 261, 262, 266, 269, 279, 280, 283, 287, 291, 299, 302, 312, 339, 342, 355, 365, 369, 375, 390, 391.)

The foregoing references (except F. R. 861 *et seq.*) relate to Phoenix' petition for modification of the decree and supporting affidavits and documents. In the Foreclosure Cause, Phoenix was denied the right to disprove this finding and to prove the facts. As above shown, this denial was predicated upon an entirely erroneous, unsupported and fraudulently induced conception by the court that Phoenix had wilfully disobeyed an order to produce books. Now on the supplemental and ancillary bill, Phoenix as the defendant is entitled to prove and establish *this fact* to support its contention that the decree of December 1, 1936 is not a "right" one. *At the trial of the Supplemental and Ancillary Cause Phoenix tendered proof of the above stated facts* (R. 282). Such tender was denied (R. 287).

The exhibits to be proved through John A. Thompson and offered in evidence in support of the tender (R. 287-290), the offered testimony of Albert Penn (R. 290) Emory H. English (R. 291) and Lee J. Skoner (R. 291) were rejected by the Curt. Theretofore the District Court had refused to permit the appellant to take the depositions of Thompson, Penn and Skoner (R. 256, 2[illegible]). The District Court refused to permit any of said witnesses to be sworn (R. 275-287; 291, 292). The witnesses Gage and Preuss were not available at the trial and not subject to subpœna (R. 272). The court had theretofore by order refused to the petitioner the right to take their depositions (R. 223).

## SPECIFICATIONS OF ERROR.

1. That the Circuit Court of Appeals for the Eighth Circuit erred in holding that the decree of December 1, 1936, in the Foreclosure Cause constituted an adjudication against Phoenix Finance Corporation of the several issues and controversies in the Supplemental and Ancillary Cause.

2. That said court erred in holding that the Trustee under a deed of trust securing a bond issue, in a proceeding to foreclose the deed of trust, "represents" the bondholder so as to permit an adjudication of contractual obligations and claims (including unpleaded counterclaims and set-offs) between a bondholder and the defendant in the Foreclosure proceeding.

3. That said court erred in holding that in the Foreclosure Cause, the involuntary impleading of a bondholder, Phoenix Finance Corporation, a Delaware corporation, as party plaintiff (the defendant mortgagor being also a Delaware corporation) gave to such impleaded bondholder the

status of an indispensable party against whom a valid adjudication on unpleaded issues may be made, and that said court further erred in failing to recognize that the result of its holding in this respect is such as to divest the Federal court of jurisdiction because of the absence of diversity of citizenship.

4. That said court erred in failing to consider the exclusive jurisdiction of the Court of Chancery of Delaware with respect to the Delaware Chancery action (see p. 27 *supra;* p. 80 *infra*) and the issues thereof as being unrelated to and unidentified with any matters before the court in the Foreclosure Cause.

5. That said court erred in so construing said decree of December 1, 1936, in the Foreclosure Cause as to deny to Phoenix the right to enforce its several claims in the Delaware courts, where jurisdiction of the parties and subject matter existed, and in so doing, denied to Phoenix due process, in violation of Article V of the Amendments to the Constitution of the United States.

6. That said court erred in that the injunctions and mandatory orders against Phoenix involved in the decrees below, whereby Phoenix is restrained from further proceeding with the pending Delaware actions and is ordered to dismiss the same at its cost and to satisfy at its cost the judgment already obtained (in connection with which a writ of error to the Supreme Court of Delaware is pending), violated Section 265 of the Federal Judicial Code and general principles of Equity Jurisprudence (the defense of *res adjudicata* being available and asserted in the Delaware actions and being legally adequate).

7. That said court erred in holding that on the Supplemental and Ancillary Bill, the Bridge Company, complainant, was not required to show that the decree in the Foreclosure Cause was a "right" one and in holding that the defendant (the petitioner herein) was not entitled to show, in a proceeding *supplemental* as well as ancillary to the Foreclosure Cause, that such decree was the result of mutual mistake (on the procedural point) and fraud, and that the complainant in the Supplemental and Ancillary Bill had not done "one equity" and was in court with "unclean hands."

8. That said court erred in failing to hold that the decree of December 1, 1936, in the Foreclosure Cause is supplemented, enlarged and "pieced out" by this decree in the Supplemental and Ancillary Cause, and that, therefore, under the decisions of this Court, the equitable principle known as "Lord Redesdale's Rule" is applicable.

9. That said court erred in failing to hold that the District Court should have taken cognizance in the Supplemental and Ancillary Cause of the tendered proof of fraud inherent in its decree in the Foreclosure Cause.

## SUMMARY OF ARGUMENT.

## ARGUMENT.

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### Point I.

**The Test as to the Scope and Validity of the Decree of December 1, 1936, in the Foreclosure Cause as Constituting an Adjudication Against Phoenix Is (a) Whether Such Decree Is Entitled to "Full Faith and Credit" in Another Jurisdiction Under Article IV, Sec. 1 of the Constitution, or, (b) Whether, in a Suit in Another Jurisdiction Upon the Subject Matter of the Purported Adjudication, Res Adjudicata Is a Valid Defense.**

Actions at law and in equity having been commenced by Phoenix in the courts of Delaware, involving certain issues claimed by the Bridge Company to have been adjudicated adversely as to Phoenix in the Foreclosure Cause, the Delaware courts have for determination under the defense of *res adjudicata* pleaded by the Bridge Company in each cause, the direct question of the scope and validity of the decree of December 1, 1936, in the Foreclosure Cause. In the one case tried and submitted on June 15, 1939 (R. 439) *prior* to the filing of the supplemental and ancillary bill below on September 18, 1939 (R. 3), the Superior Court of Delaware in a considered opinion written by two Supreme Court Justices sitting in *nisi prius*, rejected the defense of *res adjudicata* and held that the decree of December 1, 1936, with respect to any adjudication against Phoenix was not entitled to "full faith and credit."

> *Phoenix Finance Corporation v. Iowa-Wisconsin Bridge Co.*, 14 Atl. (2d) 386.

In that case, the Court said in part (pp. 388-389):

"It is a general principle often held in this State, and seemingly admitted by the present parties, that a judg-

ment rendered upon the merits by a court of competent jurisdiction upon a matter within its jurisdiction, is conclusive of the rights of the parties or their privies in other actions in the same or other tribunal of concurrent jurisdiction, as to any issue necessary to the first decision and actually litigated and determined in the former action. It is only the application of this principle which creates difficulty.

Now, of course, the very essence of res adjudicata requires that that tribunal whose judgment is sought to be made final should have had jurisdiction of the subject matter and of the parties sufficient to warrant its action."

*The above case is pending decision on writ of error to the Supreme Court of Delaware (see Clerk's Certificate in Appendix).*

The decision of the Delaware Superior Court is in accord with earlier Delaware cases.

> *Fryberger v. Consolidated Electric & Gas Co., et al.*, 7 Atl. (2d) 211;
>
> *Venetsanos v. Pappas,* 184 Atl. 489 (Del. Ch. 1936;
>
> *Williams v. Daisey,* 37 Del. (7 W. W. Harr.) 161, 180 Atl. 908;
>
> *Coca-Cola Company v. Pepsi Cola Company,* 36 Del. (6 W. W. Harr.) 124, 172 Atl. 260.

The principles thus announced are in accord with the decisions of this Court.

> *Reynolds v. Stockton,* 140 U. S. 254;
>
> *Southern Pacific R. Co. v. U. S.,* 168 U. S. 1;
>
> *Baltimore S. S. Co., et al. v. Phillips,* 274 U. S. 316.

In the first cited case this court said:

(p. 265) "If the fact of a judgment rendered in a court of one State does not preclude inquiry in the courts of another, as to the jurisdiction of the court rendering the judgment over the person or the subject matter, it certainly also does not preclude inquiry as to whether the judgment so rendered was so far responsive to the issues tendered by the pleadings as to be a proper exercise of jurisdiction on the part of the court rendering it. * * *"

(p. 265) "The invalidity of the judgment depends upon the fact that it is in no manner responsive to the issues tendered by the pleadings. This idea underlies all litigation. Its emphatic language is, that a judgment, to be conclusive upon the parties to the litigation, must be responsive to the matters controverted. * * *"

Quoting from *Mundy v. Vail*, 34 N. J. Law 418, this court said (p. 268):

"The inquiry is, had the court jurisdiction to the extent claimed? Jurisdiction may be defined to be the right to adjudicate concerning the subject-matter in the given case. *To constitute this there are three essentials: First, the court must have cognizance of the class of cases to which the one to be adjudged belongs; second, the proper parties must be present; and third, the point decided must be, in substance and effect, within the issue.* * * *"

"And again: '*A judgment upon a matter outside of the issue must, of necessity, be altogether arbitrary and unjust, as it concludes a point upon which the parties have not been heard.*' " (Emphasis supplied.)

The courts of the United States are upon the same footing so far as concerns the obligations created by their judgments, as the state courts.

*Louisville etc. R. Co. v. Central Stock Yards Co.*, 212 U. S. 132.

## Point II.

**The Decree of December 1, 1936 in the Foreclosure Cause as Supplemented by the Decree of Affirmance of the Circuit Court of Appeals and the Mandate Thereof Does Not Constitute an Adjudication Against Phoenix of the Several Issues and Controversies Involved in the Supplemental and Ancillary Proceedings Because . . .**

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(a) PHOENIX WAS ONLY A "FORMAL" PARTY TO THAT PROCEEDING.

The District Court in the Foreclosure Cause held that "the trustees were the only indispensable parties plaintiff, had *exclusive control of the litigation,*" and that Phoenix "was merely *a formal and not an indispensable party*" (F. R. 211; 19 Fed. Sup. at p. 142). In the Circuit Court of Appeals, it was held (F. R. 1692; 98 Fed. (2d) at p. 420) that "*it is apparent that the Trustees are the only necessary and indispensable parties plaintiff.*"

The Supreme Court of the United States has divided parties into three classes, viz., (1) formal, (2) necessary but not indispensable, and (3) indispensable.

> *Shields v. Barrow,* 17 How. 130;
> *Williams v. Bankhead,* 19 Wall. 563;
> *Waterman v. The Canal-Louisiana Bank etc. Co., Executor,* 215 U. S. 33;
> *Minnesota v. Northern Securities Co.,* 184 U. S. 199.

The criterion by which to determine when one is a mere "formal" or "nominal" party is whether or not a decree is sought against it.

*Payne v. Hook*, 7 Wall. 425;
*Union Bank of Louisiana v. Stafford*, 12 How. 327;
*Wormley v. Wormley*, 8 Wheat. 421;
*Niles-Bement-Pond Co. v. Iron Moulders Union etc.*, 254 U. S. 77;
*Horn v. Lockhart*, 17 Wall. 570.

*No decree was sought or rendered against Phoenix in the Foreclosure Cause.* The essential quality of the decree of December 1, 1936 in the Foreclosure Cause (F. R. 202-204) is contained in the following language (F. R. 204):

> "*That foreclosure and sale of the mortgaged property be denied* * * *."

Tested by these principles, Phoenix was truly and in fact but a "formal" party in the Foreclosure Cause, and as such was not such a party against whom the Court could validly adjudicate the enforceability of its notes, contracts and accounts receivable as against the Bridge Company, the enforceability of set-offs or counter-claims of the Bridge Company against Phoenix, the right of Phoenix to require the reissue of shares of Bridge Company stock, or the right of Phoenix to assert by legal process in a court of competent jurisdiction, its mortgages or the indebtedness secured by the same.

(b) Phoenix Was Not "Represented" by the Trustees to an Extent to Put in Issue (Even if Pleaded) the Underlying Obligations of the Bridge Company to Phoenix on Contracts, Notes and Open Accounts.

The Delaware Superior Court in the one case fully tried between the parties and involving, as the sole issue,

the defense *of res adjudicata* arising from the decree in the Foreclosure Cause said (*Phoenix Finance Corporation v. Iowa-Wisconsin Bridge Company,* 14 A. (2d) 386, 389):

> "We think that in a suit to foreclose a mortgage securing a bond issue the doctrine of representation of the bondholders by the Trustee means that *the Trustee represents all bondholders in all things relating to their common or individual interest in the trust of property, or in the bonds, but that such representation does not extend beyond a consideration of the trust property, or of the bonds secured thereby.* The Trustee cannot, by implication, be held to represent the bondholders beyond the terms of the instrument under which, alone, the Trustees have their origin or existence. The subject matter upon which the representation would apply must be one as to which both the Trustee and the person represented have an interest. In this case we are not directly concerned with the question as to whether the representation of a bondholder by a Trustee includes an inquiry as to the validity of the bonds themselves, or at what stage of the proceedings such inquiry should be had. No such question is here presented, for we are in no way interested in the bonds, as such.
>
> *The foregoing conclusion is not, we think, in any way inconsistent with Kerrison v. Stewart,* 3 Otto. 155, 93 U. S. 155, 23 L. Ed. 843; *Mercantile Trust Co. v. Schlafly,* 8 Cir., 299 F. 202; *Richter v. Jerome,* 12? U. S. 233, 8 S. Ct. 106, 31 L. Ed. 132; *Beals v. Illinois, etc., R. R. Co.,* 133 U. S. 290, 10 S. Ct. 314, 33 L. Ed. 608; or *Elwell v. Fosdick,* 134 U. S. 500, 10 S. Ct. 598, 33 L. Ed. 998." (Emphasis supplied.)

The foregoing succinctly states petitioner's contention. The decrees below are to a contrary effect.

The doctrine of representation is confined to the subject of the trust. The Trustees represent the bondholder

and in things "*relating to their common interest in the trust property.*"

> *Kerrison v. Stewart, supra;*
> *Central Trust Co. v. California & N. R. Co.*, 110 Fed. 70.

The Trustee is a special, not a general, agent of the bondholders and is limited to the legitimate purposes of the relation he sustains to the security and the parties entitled to the benefit thereof.

> *Mackay v. Randolph Macon Coal Co. et al.*, 178 Fed. 881 (C. C. A. 8th);
> *Moran v. Hagerman*, 64 Fed. 499 (C. C. A. 9th);
> *Harrisburg & Eastern R. Co.'s Appeal* (Supr. Ct. Pa. 1888), 15 A. 459, 1 L. R. A. 230;
> *Iowa Title & Loan Co. v. Clark Bros. et al.*, 213 Iowa 875, 237 N. W. 336;
> *Fonda J. & G. R. Co. v. New York Trust Company*, 233 App. Div. 443, 254 N. Y. S. 266;
> *Short on Railroad Bonds and Mortgages*, Secs. 274, 497.

At the hearings in the Foreclosure Cause, counsel for the intervener [1] gave substantial corroboration to petitioner's position as herein stated. See transcript of hearings in the Foreclosure Cause, which Bridge Company counsel below requested be judicially noticed (R. 260; footnote 28, p. 48).

Petitioner's position is also well stated in the Eighth Circuit case of *Toucey v. New York Life Ins. Co.*, 102 Fed. (2d) 16 [2] as follows (p. 19):

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[1] Same counsel appearing for respondent herein.
[2] Certiorari granted January 6, 1941; No. 587; 61 S. Ct. 440.

> "The illustration of the rule is where it is made to appear in an equity suit brought to foreclose a mortgage or other lien that there is in fact no valid lien to enforce in equity. *In such cases the equity court may not proceed to adjudicate a claim of legal liability upon a promissory note or upon a purely legal obligation unrelated to equitable liens.* In such cases, the legal controversy presented is independent and distinct." (Emphasis supplied.)

In the Foreclosure Cause, the Trustees exercise a right to foreclosure conferred by Section 3 (c) of the Mortgage Deed of Trust (F. R. 37-38) as follows:

> "May, and upon the request of the holders of one-fourth in amount of (1) all the bonds outstanding hereunder, in respect of which such default in payment of principal and/or interest exists; or (2) all the bonds outstanding hereunder, in case of any other default, and in either case upon being first indemnified to its satisfaction, shall proceed to protect and enforce their rights and the rights of the bond holders under this Indenture by a suit or suits in equity, or at law, whether for the specific performance of any covenant or agreement contained herein, or in aid of the execution of any power herein granted, or for any foreclosure hereunder, or for the enforcement of any other appropriate, legal or equitable remedy, as the Trustees, being advised by counsel learned in the law, shall deem most effectual to protect and enforce the rights aforesaid."

The remedy chosen was equitable foreclosure. The "rights of the bondholders" under the Indenture involved merely the right, by foreclosure, to apply the security to the payment of the bonds. *To this extent only were the Trustees the agents of the bondholders.* No bondholder

directly or indirectly conferred upon the Trustees the right to litigate for them purely legal claims unrelated to the issue of mortgage foreclosure.

The doctrine of trustee representation is confined to the subject of the trust, or in other words, the property mortgaged and the equities of the bondholders therein. It does not extend to the indebtedness secured thereby. This principle is clearly stated in the case of *Central Trust Co. v. California & N. R. Co., supra,* as follows (p. 72, 110 of Fed.):

> "The principle that the trustee named in the mortgage given to secure the payment of bonds is the proper party to protect the interest of all the bondholders, and that individual bondholders will not be permitted to take part in the litigation, is not applicable to a controversy involving the validity of bonds for the satisfaction of which the foreclosure proceedings are being conducted."

See also:

*Mackay v. Randolph Macon Coal Co., supra;*
*Moran v. Hagerman, supra;*
*Harrisburg & Eastern R. Co.'s Appeal, supra;*
*Fonda J. & G. R. Co. v. New York Trust Co., supra.*

*Analysis of Cases relied upon as supporting decrees below.*

*Kerrison v. Stewart,* 3 Otto 155, involved an assignment in trust for the benefit of the creditors and the effect of an adjudication against the trustee to which the creditors were not a party. The Court recognized that the trustee does not always represent the beneficiaries in all matters pertaining to the trust, saying (pp. 160-161):

> "* * * The difficulty lies in ascertaining whether he [the trustee] occupies such a position not in determining its effect if he does. * * *

)

> "Undoubtedly, cases may arise in which it would be proper to have before the court the beneficiaries themselves, or someone other than the trustee to represent their interests. * * *"

> "It remains to determine whether Charles Kerrison was authorized to represent the creditors in proceedings against him to defeat the title he held for their security. This depends upon the intention of the parties, as expressed in the deed creating the trust and making him the trustee. * * *"

The Court then analyzed the instrument and found (p. 161):

> "From this it appears that he was not only invested with the legal title to the property, but that all parties relied upon his judgment and discretion for the protection of their respective interests. A clear intent is manifested of relieving the creditors from the necessity of looking personally to the conversion of the securities or to the preservation of the trust. * * *"

*The adjudication, of course, was confined to the trust res to which the trustee held title and did not affect the claims of the creditors, to which the trustee had no title.*

In quoting from *Beals v. Ill. M. & T. R. Co.,* 133 U. S. 290, counsel for the Bridge Company has heretofore attempted to make it appear that the jurisdiction of the Court to declare the trust deed and the bonds invalid arose from the fact that the trustee under the mortgage was a party defendant and represented the bondholders. The fact is that the bondholders had all been made parties defendant and all known resident bondholders (p. 292) "were actually served with process, and all nonresident bondholders who could be named, together with all unknown bondholders, were duly served by publication;" and that (p. 293) "many

bondholders appeared and pleaded, putting in issue the allegations of the petition," so that there was class representation of the bondholders themselves in the proceedings. The case is not an authority for the proposition that bondholders need not be parties in a suit to invalidate their bonds.

*Elwell v. Fosdick,* 134 U. S. 500, was a suit to quiet title in which the trustee under a former mortgage was made a party defendant. Judgment was entered against the trustee and he released errors and waived the right of appeal. It was held that the release was binding upon the bondholders but it needs no argument to show that the holding affected only the security and not the indebtedness.

In *Richter v. Jerome,* 123 U. S. 233, the sole question was as to the security. The validity of the debt was not in issue and the Court found (at page 247):

> "Here the Trust Company began its suit for the foreclosure of its mortgage, and has sold under the decree in that suit all the interests, legal and equitable, which it held in the land as trustee for the bondholders, and distributed the proceeds, the complainant receiving his share without complaint and without objection. All the rights which the Trust Company, as trustee, had in the lands at the time of the mortgage passed to the purchaser at the sale. * * *."

In *Mercantile Trust Co. v. Schlafly,* 299 Fed. 202, the indebtedness was not in issue; the trustee in bankruptcy merely recovered a preference from the party to whom it had been made and who still held the money. The fact that he held it in trust was immaterial.

*The Iowa Rule as to Trustee Representation Is Conclusive.*

It has been heretofore pointed out that the Foreclosure Cause, by reason of the intervention of Kendrick, *took the*

*form of a suit for cancellation of both mortgage and bonds.* The intervention petition was regarded by intervener's counsel, the Master and Court as being in effect a *cross-bill for cancellation.* The final decree in the Foreclosure Cause purports to cancel both mortgage and bonds for fraud (F. '. 203-204). Assuming this issue to have been properly raised and to have been within the jurisdiction of the court to decide, who were the indispensable parties thereto?

In Iowa it is held that the holder of the indebtedness secured by a mortgage is a "necessary" party to a suit attacking the mortgage for invalidity of the indebtedness.

*Clemons v. Elder*, 9 Iowa 272.

In a suit in equity to invalidate a written instrument alleged to be fraudulent, the Iowa Court has held that all parties thereto must be before the Court.

*Miller et al. v. Mahaffy et al.*, 45 Iowa 289.

In another case, the Supreme Court of Iowa recognized the fundamental distinction between the representative powers of the Trustee with respect to foreclosure of the security and the Trustee's powers with respect to the validity of the underlying indebtedness.

*Iowa Title & Loan Company v. Clark Bros. et al.*, 213 Iowa 875; 237 N. W. 336.

These are rules of substantive law in Iowa and as such are controlling on the Federal courts.

*Erie R. R. v. Tompkins*, 304 U. S. 64;
*Ruhlin v. New York Life Insurance Co.*, 304 U. S. 202.

The position of the Bridge Company, respondent herein, as stated in its Supplemental and Ancillary Bill below,

is that by the Foreclosure Decree *"all matters and differences"* between Phoenix and the Bridge Company *"were fully settled, adjudicated and determined"* (R. 3). The District Court used *identical* language in its findings on motion for preliminary injunction (R. 121, Four) and in its order for preliminary injunction (R. 133). The final decree (R. 719-722) gives effect to this basic error.

By this ruling below, Phoenix, a *formal party only* to the Foreclosure Cause, is restrained from suing Bridge Company on the underlying indebtedness and claims. This, it is submitted, extends the doctrine of representation to unprecedented bounds and applies to the principles of estoppel by judgment a concept which has the effect of depriving Phoenix of due process of law.

(c) There Were No Issues in the Foreclosure Cause Involving Phoenix and No Issues Framed in the Cause as to Any Party Justifying an Adjudication Against Phoenix of the Issues Raised by the Supplemental and Ancillary Bill.

An adjudication to be valid (apart from the question of parties) must be within the issues as defined by the pleadings.

> *Reynolds et al. v. Stockton, Receiver, supra;*
> *Southern Pacific Ry. Co. v. U. S., supra;*
> *Baltimore Steamship Co. v. Phillips, supra.*

In *Reynolds et al. v. Stockton, Receiver, supra,* this court said (p. 268 of 140 U. S.):

> "* * * A judgment upon a matter outside the issue must, of necessity, be altogether arbitrary and unjust, as it concludes a point upon which the parties have not been heard. * * *"

At another point, the Court said (p. 269):

> "* * * Thus, Lord Coke, treating of this doctrine says: 'A matter alleged that is neither traversable nor material shall not estop.' Co. Litt. 352b * * *."

In *Southern Pacific R. Co. v. U. S., supra,* the rule is stated as follows (p. 48 of 168 U. S.):

> "The general principle announced in numerous cases is that a right, question or fact distinctly put in issue and directly determined by a court of competent jurisdiction as a ground of recovery, cannot be disputed in a subsequent suit between the same parties or their privies; * * *."

In *Baltimore Steamship Co. v. Phillips, supra,* the Supreme Court said (p. 602 of 274 U. S.):

> "* * * But if the second case be upon a different cause of action, the prior judgment or decree operates as an estoppel only as to matters actually in issue or points controverted, upon the determination of which the judgment or decree was rendered."

In *Bates v. Bodie,* 245 U. S. 520, this Court said (p. 526):

> "* * * And this court has established a test of the thing adjudged and the extent of its estoppel. It is: If the second action is upon the same claim or demand as that in which the judgment pleaded was rendered, the judgment is an absolute bar not only of what was decided but of what might have been decided. If the second action was upon a different claim or demand, then the judgment is an estoppel 'only as to those matters in issue or points controverted, upon the determination of which the finding or verdict was rendered (citing cases) * * *.'"

In the Eighth Circuit in the case of *Union Central Life Ins. Co. v. Drake,* 214 Fed. 536, the Court said (p. 545):

> "* * * But there was no pleading of or prayer for a subrogation of the insurance company to the rights of the first mortgagee to his liens upon the three forties, *and evidence without pleading is as futile to sustain an adjudication of an issue as pleading without proof.*" (Emphasis supplied.)

The celebrated *Duchess of Kingston's Case*, 20 St. Tr. 361, is also an authority frequently cited. Therein the rule is stated:

> "But neither the judgment of a court of concurrent or exclusive jurisdiction is evidence of any matter *which comes collaterally in question*, though within their jurisdiction, nor of any matter incidentally cognizable, nor of any matter *to be inferred* by argument from the judgment." (Emphasis supplied.)

The necessity of identity of issues for estoppel by judgment to apply is also well established by the following authorities:

*Cromwell v. County of Sac*, 94 U. S. 351;
*Landon v. Clark*, 221 Fed. 841;
*Kicinko et al. v. Petruska et al.*, 259 Pa 1, 102 Atl. 286;
*Lewis & Nelson's Appeal*, 67 Pa. 153;
*Yost v. Yost*, 172 Md. 128; 190 Atl. 753;
*Smith v. Rountree*, 185 Ill. 219; 56 N. E. 1130;
*2 Freeman on Judgments* (5th ed.), Sec. 627, p. 1322;
*1 Freeman on Judgments* (5th ed.), Sec. 337, p. 674; Sec. 355, p. 738.

In the last cited text, the principle is stated in the following apt language (p. 738):

> "* * * For courts cannot *ex mero motu* set themselves in motion, nor have they power to decide ques-

tions except such as are presented by the parties in their pleadings. * * *"

*There is no ambiguity in the decree of December 1, 1936, in the Foreclosure Cause which justifies a reference to the opinion to determine the issue decided.*

A comprehensive statement of this rule is found in *Bower on Res Judicata*, Section 173, as follows:

"For the purpose of ascertaining the subject-matter of the decision relied upon as a res judicata, only the record (in the formal sense) of the judgment itself, and such pleadings and other proceedings, if any, as tend to show what particular questions of law or issue of fact must necessarily have been determined by the tribunal in adjudicating as it did, can be examined. Where an express declaration as to any particular question or issue appears on the face of the record of the formal judgment, (a) or where 'from the judgment itself the actual grounds of the decision can be clearly ascertained,' there is no necessity for further search; but it is not permissible, where there is no such express declaration, to examine 'what was said by the judges,'—in delivering their oral judgments—'for the purpose of discovering what were the real grounds of their decision.' (b) The convenience, to say the least of it, of adopting such a practice is obvious, particularly in any case where the judicial tribunal consisted of two or more persons." * * *

The decree and not the opinion of the Court determines the scope of an adjudication.

*Doyle v. Hamilton Fish Corp.*, 234 Fed. 47 (C. C. A. 2d);

*J. J. Hockenjos Co. v. Lurie* (Supr. Ct. N. J. 1934), 173 Atl. 913;

*Mullaney v. Mullaney*, 65 N. J. Eq. 384, 54 Atl. 1086.

In *The Drifter*, 35 F. (2d) 1006, the Court stated (p. 1007):

"It is well settled that the decision or opinion of a court or the verdict of a jury does not make a matter res judicata. In order to secure that result, a judgment must be entered. Reed v. Proprietors of Locks, etc., on Merrimac River, 8 How. 274, 290, 291, 12 L. Ed. 1077; Smith v. McCool, 16 Wall. 560, 561, 21 L. Ed. 324; King v. Chase, 15 N. H. 14, 41 Am. Dec. 675; Lorillard v. Clyde, 99 N. Y. 196, 200, 1 N. E. 614; Springer v. Bien, 128 N. Y. 99, 102, 27 N. E. 1076."

See also:

*D. L. Flack & Son, Inc. v. West Virginia Coal Co.*, 46 F. (2d) 177;

*United States v. Davis et al.*, 3 F. Supp. 97;

*Société Vinicole De Champagne v. Mumm Champagne & Importation Co., Inc.*, 10 F. Supp. 289.

*There could have been no valid adjudication of a set-off or counterclaim in the Foreclosure Case without appropriate pleading.*

As heretofore shown, the District Court in the Foreclosure Cause purported to disallow two admittedly bona fide items of indebtedness of the Bridge Company to Phoenix in the sums of $3,125 and $9,000 because of an alleged set-off or counterclaim of the Bridge Company against the same (F. R. 177-178; 19 Fed. Supp. at p. 140). There were no pleadings in the cause tendering such an issue.[8]

The proposition is well settled that "set-off" is an affirmative defense that must be affirmatively pleaded in

[8] In the $3,125-$2,000 note case in Delaware (now pending decision in Delaware Supreme Court), the Bridge Company *did* plead "set-off." (R. 421; 391; 427). *This defense was abandoned,* the sole issue at the trial being *res adjudciata* (14 Atl. (2d) at p. 386).

order that advantage may be taken thereof by the party asserting the same.

> *McGowan v. American Pressed Tan Bark Co.*, 121 U. S. 575;
> *United States v. Mitchell*, 205 U. S. 161;
> *Stanley v. Turner*, 68 Vt. 315, 35 A. 321 (Sup. Ct. of Vt., 1896);
> *Freeman v. Marsh*, 3 N. J. L. 65;
> *Hildebrand v. American Fine Art Co.*, 109 Wis. 171, 85 N. W. 268;
> *State v. Board of Commissioners*, 22 N. M. 562, 166 P. 906;
> *Wingate v. Parsons*, 4 Del. Ch. 117.

Accordingly, even if valid adjudications had existed as to all other issues and the Court had had the necessary jurisdiction, the findings as to these two items must fall for want of sufficient pleading.

*The Delaware Chancery Court has exclusive jurisdiction to determine the issues of the action to secure redelivery to Phoenix of 517 shares of Bridge Company preferred stock (see Statement, pp. 27-30 supra).*

The facts have been stated heretofore showing that there was in fact and in law no issue in the Foreclosure Cause capable of adjudication on this point. Even if there had been, the District Court in the Foreclosure Cause lacked jurisdiction.

In the Delaware Chancery action, Phoenix is seeking to recover the stock *because there was an impairment of the Bridge Company's capital at the time of the transaction,* in violation of Sec. 19 of the General Corporation Law of

Delaware.[4] The transaction is also attacked because of the violation of the provisions of the Bridge Company's corporate charter.[5]

In the Delaware action, Phoenix has tendered the bonds received for the stock. The Bridge Company's defense is *res adjudicata* or estoppel by the decree in the Foreclosure Cause. Both corporations are domiciled in Delaware and, as to the issues in the Delaware Chancery case, no Federal Court has jurisdiction. The matter involved relates peculiarly to the internal affairs of a Delaware corporation.

2105 Sec. 75 of the Revised Code of Delaware, 1935 (Section 75 of the Corporation Law) provides:

> "For all purposes of title, action, attachment, garnishment and jurisdiction of all courts held in this State, but not for the purpose of taxation, the situs of the ownership of the capital stock of all corporations existing under the laws of this State, whether organized under this Chapter or otherwise, shall be regarded as in this State."

In *Rogers v. Guaranty Trust Co.*, 288 U. S. 123, this Court said (p. 130):

> "It has long been settled doctrine that a court—state or federal—sitting in one state will, as a general rule, decline to interfere with, or control by injunction or otherwise, the management of the internal affairs of a corporation organized under the laws of another State but will leave controversies as to such matters to the courts of the State of the domicile. * * *"

In the recent case of *Wojtczak v. American United Life Ins. Co.* (Mich. June, 1940), 292 N. W. 364, the Court

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[4] See footnote, p. 28, *supra*.

[5] The Bridge Company charter is in evidence in the Foreclosure Cause. The appropriate clauses appear at F. R. 1640, 1645.

quoted from *Rogers v. Guaranty Trust Co., supra,* and reviewed the leading cases on the point. On the subject as to the character of the acts which relate to internal management, the Michigan Court quoted with approval from *North State Copper & Gold Mining Co. v. Field,* 64 Md. 151, 20 Atl. 1039, where that court said (at p. 1040):

> "* * * It may not be, in all cases, easy to draw a clear line of distinction between the acts of a corporation relating to its internal management, and those which do not. But we apprehend the distinction to be this: That, where the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as stockholder, director, president, or other officer, and is the act of the corporation, whether acting in stockholders' meeting, or through its agents, the board of directors, then such action is the management of the internal affairs of the corporation, and, in case of a foreign corporation, our courts will not take jurisdiction. Where, however, the act of the foreign corporation complained of affects the complainant's individual rights only, then our courts will take jurisdiction, whenever the cause of action arises here."

In *Alm v. American Hair & Felt Co.,* 91 F. (2d) 354 (C. C. A. 7), a stockholders' suit had been filed to restrain the operation of a plan of a Delaware corporation involving the redemption of its common stock and its subsequent redistribution. The Circuit Court of Appeals affirmed the decree of the District Court declining jurisdiction, stating (at p. 358):

> "We are convinced that the controlling issue, and in fact the only issue, here presented must turn upon whether the acts complained of concerned only the management and internal affairs of appellee a foreign cor-

poration. That question must be answered in the affirmative."

See also:

*Kansas, etc., Const. Co. v. Topeka, S. & W. R. Co.,* 135 Mass. 34;

*Kimball v. St. Louis & S. F. R. Co.,* 157 Mass. 7;

*Mau v. Montana Pacific Oil Co.,* 16 Del. Ch. 114, 141 A. 828;

*In re Fryeburg Water Co.,* 79 N. H. 123; 106 Atl. 225;

*Jackson v. Hooper,* 76 N. J. Eq. 592; 75 Atl. 568;

*17 Fletcher's Cyclopedia on Private Corporations* (1933), Sec. 8435, p. 396.

In *Black v. Zacharie,* 3 How. 483, this Court said:

"* * * From the nature of the stock of a corporation, which is created by and under the authority of a State, it is necessarily, like every other attribute of the corporation, to be governed by the local law of that State, and not by the local law of any foreign state. * * *"

In the Delaware Chancery action, Phoenix is complaining of an act affecting it solely in its capacity as a stockholder of Bridge Company. The act complained of is a transaction in violation of Delaware law and of the charter provisions of a Delaware corporation. The act was the act of the Bridge Company by its board of directors.

*In the Foreclosure Cause the understanding of the parties and the Master respecting two distinct stages in the proceeding is in conformity with established Federal practice. In no event was the validity of bonds in issue at the first stage.*

The position of the Trustee Complainants in the Foreclosure Cause, as to the "two-stage" theory of the case as

heretofore stated,[6] and the acquiescence of the Master therein, was correct as a matter of law and practice, and Phoenix was prevented by the Trustee Complainants from offering its evidence because of the reliance of the parties and the Master upon that practice.

The well established rule in foreclosure cases in the Federal Court is that the decree of foreclosure and sale is to be entered before the ownership and validity of individual bonds can be determined.

> *Dickerman v. Northern Trust Co.*, 176 U. S. 181;
> *Guaranty Trust & Safe Deposit Co. v. Green Cove, etc., R. R.*, 139 U. S. 137;
> *First National v. Shedd*, 121 U. S. 74;
> *Union Trust v. Jones*, 16 Fed. (2d) 236;
> *Fidelity Trust v. Washington*, 217 Fed. 588;
> *Mercantile Trust Co. v. U. S. Ship Building Co.*, 130 Fed. 725;
> *Toler v. East Tennessee, etc.*, 67 Fed. 168;
> *Farmers Loan & Trust v. Toledo*, 67 Fed. 49.

*Upon the basis of the foregoing practice, it cannot be said that Phoenix was derelict in not offering proof of the consideration for and validity of its bonds at the first procedural stage.*

## Point III.

### The Injunctions and Mandatory Orders Against Phoenix Below, Restraining It From Prosecuting the Pending Delaware Actions and Requiring It to Dismiss Said Actions Violates Principles of Equity Jurisdiction.

In each of the Delaware actions, Phoenix has appeared generally and has pleaded the defense of *res adjudicata* or

[6] See p. 14 and footnote 13, pp. 15-16, *supra*.

estoppel by reason of the decree of December 1, 1936, in the Foreclosure Cause. Such defense being available, the District Court below should have dismissed the Supplemental and Ancillary Bill.

*High on Injunctions,* (4th Ed.) Sec. 89, p. 100, succinctly states the rule:

> "The most frequent ground for refusing relief by injunction against a suit at law is that the defense urged may be used in the action at law itself, without resort to equity. And it may be laid down as a general rule that legal proceedings will not be enjoined on grounds of which the person aggrieved may avail himself in defense of the action at law. * * *"

The rule thus stated has the judicial sanction of the Supreme Court:

> *Creath's Admr. v. Sims,* 5 How. 192;
> *Hendrickson v. Hinckley,* 17 How. 443;
> *Marine Ins. Co. v. Hodgson,* 7 Cranch. 332;
> *Phillips v. Negley,* 117 U. S. 665;
> *Knox County v. Harshman,* 133 U. S. 152;
> *Deweese v. Reinhard,* 165 U. S. 386;
> *Truly v. Wanzer,* 5 How. 141;
> *Scottish U. & N. Ins. Co. v. Bowland,* 196 U. S. 611.

See also:

> 5 *Pomeroy's Equity Jurisprudence* (4th ed.), Sec. 2059, pp. 4650-4651.

In the case of *Smith v. Short,* 11 Ia. 523, the Supreme Court of Iowa said (p. 524):

> "* * * For aught that is shown, every matter stated in the bill can be made as fully available in answer and

defense, to the action at law, as by an appeal to equity. Under such circumstances, the parties should be left to their legal remedies and defenses."

Furthermore, Phoenix is entitled to a jury trial on the purely *legal* issues involved in the Delaware law actions. The Eighth Circuit Court in *New York Life Ins. Co. v. Stoner*, 92 Fed. (2d) 845, said (p. 849):

> "* * * The granting of equitable relief would deprive defendant of the right to a jury trial, which should not be done without very substantial reasons therefor. * * *"

In the $3,125-$2,000 notes case, discussed in the Statement (p. 25), the defense of *res adjudicata* was not only available but was pleaded, litigated and decided (14 Atl. (2d) 386). Writ of error is pending decision in the Supreme Court of Delaware (see Clerk's Certificate in Appendix). If the Superior Court is affirmed, the Bridge Company has remedy by appeal to this court, in which event the Federal question should relate to the Full Faith and Credit Clause of the Constitution (Article IV, Sec. 1).

## Point IV.

### The Injunctions and Mandatory Orders Against Phoenix Below Violate Section 265 of the Judicial Code.

Section 265 of the Judicial Code (36 Stat. 1162; 28 U. S. C. A., Sec. 379) provides:

> "The writ of injunction shall not be granted by any court of the United States to stay proceedings in any court of a State, except in cases where such injunction may be authorized by any law relating to proceedings in bankruptcy."

A restraint against a party offends against the Section to the same extent as an injunction formally directed against the State Court itself.

> *Oklahoma Packing Company v. Oklahoma Gas & Electric Co.*, 309 U. S. 4.

Certain supposed exceptions to the rule are enumerated by the Eighth Circuit Court of Appeals in the case of *Equitable Life Assr. Society v. Wert*, 102 F. (2d) 10, 14. None of the exceptions therein stated are applicable to the facts here.

Even where the Federal Court has property in its possession, there are limits to the exercise of its power to enjoin. In *Guardian Trust Co. v. Kansas City Southern Railway Co.* (C. C. A. 8), 171 Fed. 43, 50, it was stated:

> "* * * the unquestioned rule that the pendency in a state or other court of an action *in personam* which involves no claim to or lien upon specific property in the possession or under the dominion of a national court of equity, and no issue of which that court has acquired exclusive jurisdiction, presents no ground for a dependent bill to stay it." (citing cases).

In the Chancery and law actions in Delaware, no relief is asked "affecting the control, possession or disposition of the res," now in the possession of the receiver of the District Court. No liens, claims or charges against the property are asserted. All the Delaware proceedings are *in personam* only.

It may be, as the Circuit Court said in *Equitable Life Assr. Society v. Wert, supra,* that a Federal equity court may "secure or preserve the fruits and advantages of a judgment or decree rendered therein." The sole question here is: To what "fruits or advantages" is the Bridge

Company entitled? What rights were secured and what burdens were imposed by the final decree of December 1, 1936, in the Foreclosure Cause? Could an action *in rem* to impose a specific lien on specific property bear fruits *in personam* beyond the issues and the parties indispensably in court? Did the Bridge Company litigate its indebtedness in a foreclosure suit in which its creditors were not indispensable parties? Did the "fruits and advantages" of the decree in that suit, brought to establish a specific lien on specific bridge properties, by trustees who "had exclusive control of the litigation," comprehend the stripping of Phoenix of its choses in action which were not a part of the *trust res*, and which the trustees did not hold, represent or control?

## Point V.

**A Construction of the Decree of December 1, 1936, as Denying to Phoenix the Right to Enforce Its Claims and to Litigate the Same in Courts Having Jurisdiction of the Parties and of the Subject Matter, Constitutes a Deprivation of the Property and Property Rights of Phoenix, in Violation of Article V of the Amendments to the Constitution of the United States.**

The Fifth Amendment to the Constitution of the United States is in part as follows:

> "No person shall * * * be deprived of life, liberty, or property, without due process of law; * * *"

The Judicial Department of the Federal Government is necessarily governed in the exercise of its functions by the rule of due process in the Fifth Amendment.

*Hovey v. Elliott*, 167 U. S. 409.

In judicial proceedings, due process of law must be a course of legal proceedings, according to those rules and forms which have been established for the protection of private rights. It must be one that is appropriate to the case and just to the parties affected. It must be pursued in the ordinary manner prescribed by the law. It must give to the parties to be affected an opportunity to be heard respecting the justice of the judgment sought. It must be one which hears before it condemns, proceeds upon inquiry, and renders judgment only after trial.

> *Hurtado v. California*, 110 U. S. 516;
> *Murray v. Hoboken Land &c. Co.*, 18 How. 272;
> *Burton v. Platter*, 53 F. 901;
> *Thomas v. District of Columbia*, 90 F. (2d) 424;
> *Albion-Idaho Land Co. v. Naf. Irr. Co.*, 97 F. (2d) 439, 444.

Judgments are conclusive only as to parties and their privies but even parties and privies are bound only so far as regards the subject-matter then involved.

> 1 *Cooley's Constitutional Limitations* (8th ed.), p. 112.

Thus if certain facts were not necessarily included in the issue, a party is not concluded by the judgment as to them.

> *Bates v. Bodie, supra;*
> *Doonan v. Glynn*, 28 W. Va. 715;
> *Lorillard v. Clyde*, 99 N. Y. 196, 1 N. E. 614;
> *City of Rushville v. Rushville National Gas Co.*, 164 Ind. 162, 73 N. E. 87, 3 Ann. Cas. 86.

## Point VI.

**If the Decree of December 1, 1936 in the Foreclosure Cause Did Constitute an Adjudication of Such Issues Against Phoenix, Phoenix Must Necessarily Have Had the Status of "Indispensable" Party, and Those Issues Involving Legal Claims ~~Against~~ between Phoenix, a Delaware Corporation, as Plaintiff, and the Bridge Company, a Delaware Corporation, as Defendant, the Federal Court Had No Jurisdiction Thereof.**

Under this heading, it is assumed *arguendo,* as the Court below held, that there *was* a valid adjudication against Phoenix, a Delaware corporation, with respect to legal and equitable issues. With such issues we must regard Phoenix as the party plaintiff (or defendant to any counter-claim or set-off) and the Bridge Company, another Delaware corporation, as the party defendant (or plaintiff to any counterclaim or set-off). It is true that these things were not involved in the issue of mortgage foreclosure, but the Court below has said that these issues were decided. How does this affect Federal jurisdiction?

Phoenix must of necessity have been an "indispensable" party for there to have been an adjudication against it on any issue involved in the Supplemental and Ancillary Bill.

An "indispensable" party is one who not only has an interest in the controversy, but who has an interest of such a nature that a final decree cannot be made without affecting that interest.

> *Cunningham v. Macon & B. R. Co.,* 109 U. S. 446;
> *Shields v. Barrow, supra.*

Here we will assume, as the Court below held, that the decree in the Foreclosure Cause did, in fact, so "affect"

the interests of Phoenix as to constitu e a comprehensive adjudication against it. The Court below, it is submitted, has thus arrived at a conclusion, the effect of which is to render void *for want of jurisdiction* any such purported adjudication against Phoenix.

The Constitution (Art. III, Sec. 2) limited Federal jurisdiction in the Foreclosure Cause to "controversies * * * between citizens of different states."

The joinder of defendants who are citizens of the same state as the complainants, will not oust Federal jurisdiction *where they are not indispensable parties.*

> *Weiland v. Pioneer Irr. Co.*, 238 Fed. 519; affd. 259 U. S. 498.

The joinder of a formal or nominal party in such case does not deprive the Federal Court of jurisdiction.

> *Wormley v. Wormley*, 21 U. S. 421;
> *Carneal v. Banks*, 23 U. S. 181;
> *Shields v. Barrow, supra.*

*As to the issue of mortgage foreclosure, there was undisputed Federal jurisdiction.* The trustee complainants were respectively a corporation cf Iowa and an individual resident of Wisconsin. The defendant, the Bridge Company, was a Delaware corporation.

If the intervention petition be construed as raising *an issue of cancellation of bonds,* then Phoenix, a bondholder, was an *indispensable* party to that issue. If any pleadings are to be construed as creating a justiciable issue as to the collectibility and enforceability of Phoenix' notes, contract and accounts receivable against Bridge Company or Bridge Company's set-offs or counterclaims against Phoenix, then also Phoenix was necessarily an *indispensable* party.

As to such assumed issues, Phoenix and Bridge Company (both Delaware corporations) were arrayed on opposite sides of the controversy. This is not a question of *ousting* Federal jurisdiction. That jurisdiction existed and remained *solely as to mortgage foreclosure. As to the other assumed issues, the jurisdiction never existed.*

The question here presented is, therefore, clearly distinguishable from that involved in *Supreme Tribe of Ben Hur v. Cauble*, 255 U. S. 356, where in a *class suit* it was held that the *voluntary* intervention as plaintiff of a citizen of the same state as the defendant did not oust Federal jurisdiction.

In *St. Paul Mercury Indemnity Co. v. Red Cab Co.*, 303 U. S. 283, this Court said (p. 288):

> "The intent of Congress drastically to restrict Federal jurisdiction in controversies between citizens of different states has always been rigorously enforced by the courts. * * *"

In *Chicago, B. & Q. Ry. Co. v. Willard*, 220 U. S. 413, the Supreme Court quoting from *Martin v. B. & O. R. R.*, 151 U. S. 673, 689, said (p. 420):

> "Diverse State citizenship of the parties * * * is absolutely essential, and cannot be waived, and the want of it will be error at any stage of the cause, even though assigned by the party at whose instance it was committed."

See also:

*U. S. et al. v. Corrick*, 298 U. S. 435, 440;
*McNutt v. General Motors Acceptance Corp.*, 298 U. S. 178, 184;
*M. C. & L. M. Ry. Co. v. Swan*, 111 U. S. 379, 382;
*Williams v. Nottawa*, 104 U. S. 209.

The decision in the Foreclosure Cause (contrary to the decree in the Supplemental and Ancillary Cause) assumes that Phoenix was a "formal" and not an "indispensable" party to the suit. In this respect, that decision was in conflict with the decisions of the Supreme Court of Iowa *if we are to assume an issue as to cancellation the mortgage and bonds.* In a suit to cancel a mortgage, the Iowa Court has held that all beneficiaries interested in the mortgage debt must be made parties.

*Clemons v. Elder, et al., supra.*

The answer and intervention petition in the Foreclosure Cause demanded cancellation both of the mortgage and of the bonds. In a suit in equity to invalidate a written instrument alleged to be fraudulent, the Iowa decisions hold all parties to it must be before the court (i. e. *indispensable* parties).

*Miller et al. v. Hahaffy et al., supra.*

In *Erie Railroad Co. v. Tompkins, supra,* this Court said (p. 73 of 304 U. S.):

> "* * * the Federal courts exercising jurisdiction in diversity of citizenship cases would apply as their rules of decision the law of the state, unwritten as well as written."

And in *Ruhlin v. New York Life Ins. Co., supra,* it was stated (p. 205 of 304 U. S.):

> "* * * The doctrine applies though the question * * * arises not in an action at law, but in a suit in equity."

In *Shields v. Barrow, supra,* this Court found absence of original jurisdiction after thirteen years of litigation in the lower Federal courts (p. 146 of 17 How.). There, as here, it was sought to invalidate a contract, one of the

parties to which was of the same state as the party raising the controversy. It was held that "a bill to rescind a contract presents an example" of indispensable parties (p. 139). The presence of each party to the contract is a prerequisite to equity jurisdiction. Equity could make no decree without them. And if, by joinder, one destroyed diversity of citizenship, it ousted jurisdiction of the Federal courts.

To the same effect is *Ribon v. R. R. Companies,* 16 Wall. 446, 450, holding that where "the interests of those present and those absent are inseparable, the obstacle is insuperable."

See also

*Northern Indiana R. Co. v. Michigan Central R. Co.,* 15 How. 233, 245.

In *Minnesota v. Northern Securities Co.,* 184 U. S. 199, 246, 247, this Court said:

> "When it appears to a court of equity that a case, otherwise presenting ground for its action, cannot be dealt with because of the absence of essential parties, it is usual for the Court, while sustaining the objection, to grant leave to the complainant to amend by bringing in such parties. But when it likewise appears that necessary and indispensable parties are beyond the reach of the jurisdiction of the court, or that, when made parties, the jurisdiction of the court will thereby be defeated, for the court to grant leave to amend would be useless. Sec. 2 of Article 3 of the Constitution of the United States."

See also:

*Gregory v. Stetson,* 133 U. S. 579, 587;
*Niles-Bement-Pond Co. v. Iron Moulders Union,* 254 U. S. 77, 82;

*Trimble v. Winston Co.*, 56 F. (2d) 150 (C. C. A. 5).

In *Swan Land & Cattle Co. v. Frank*, 148 U. S. 603, 610, this Court said:

"Now, it is too clear to admit of discussion that the various corporations charged with the fraud * * * are necessary and indispensable parties to any suit to establish the alleged fraud * * *."

See also:

*Gaylor v. Kelshaw*, 68 U. S. (1 Wal.) 81, 82;
*Nougue v. Clapp*, 101 U. S. 551, 553;
*Garzot v. De Rubio*, 209 U. S. 283, 297;
*Hill v. Wilson*, 210 Fed. 200 (C. C. A. 5).

The Judicial Code, Section 37, as amended, imposes a duty upon the Federal Courts to dismiss any suit when it appears from the pleadings or the proofs "that such suit does not really and substantially involve a suit or controversy properly within the jurisdiction of said court," as defined by the Constitution and further limited by statute.

Jurisdiction cannot be waived and an appellate Federal court can and should consider the question on its own motion even if not raised.

*Chicago, B. & Q. Ry. Co. v. Willard*, 220 U. S. 413.

## Point VII.[7]

**By Reason of the Equitable Maxim: "He Who Seeks Equity Must Do Equity," and the Particular Application Thereof known as "Lord Redesdale's Rule," the Bridge Company by Its Bill of Complaint Supplemental and Ancillary to the Foreclosure Decree Was Required to Show That Such Decree Was a "Right" One and Phoenix by Its Answer and Counterclaim and by Evidence in Support Thereof Was Entitled to Show That Such Decree Should Not Be Implemented.**

The Supplemental and Ancillary Bill seeks to enjoin, and the decrees below do in fact enjoin, Phoenix from asserting certain *bona fide* claims. These claims are all parcel of a general account between the parties shown with great certainty and clarity by defendant's rejected Exhibit S. C. 114 (R. 595-693). Those claims are further explained by paragraphs 17 to 38 of the Answer and Counterclaim of Phoenix (R. 153-164) stricken by the District Court (R. 171). By its Supplemental and Ancillary Bill, it is the Bridge Company that is now "seeking equity."

The general principle underlying the maxim has universal judicial recognition.

> *Thomas Tr. v. Brownville, &c. R. Co. et al.*, 109 U. S. 522;
>
> *Union Central Life Co. v. Drake*, 214 Fed. 536, 548 (C. C. A. 8th).

In *King et al. v. Hamilton et al.*, 4 Pet. 311, the Supreme Court said (p. 328):

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[7] Points VII, VIII and IX *infra* need not be considered if the Court agrees with petitioner's primary contention, viz., that the decree in the Foreclosure Cause did not validly adjudicate the issues of the Supplemental and Ancillary Bill adversely to Phoenix for the reasons, or any of them, heretofore stated.

"* * * When a party comes into a Court of Chancery seeking equity, he is bound to do justice, and not ask the Court to become the instrument of iniquity."

In the application of the maxim as a defense to the relief prayed, this case is governed by a rule, universally recognized and commonly referred to as "Lord Redesdale's Rule," in tribute to the statement of the rule by that famous Chancellor (author of Mitford's Chancery Pleadings) in *Hamilton v. Houghton*, 2 Bligh. 169, 193, 4 Eng. Rep. 290, 299, as follows:

"The party who comes into a court of equity to have the benefit of a former decree, must show that it was a *right* decree, if the decree appears to be erroneous, the Court cannot carry it into execution."

The rule is stated in even more emphatic form by Lord Chancellor Sugden in *O'Connell v. M'Namara*, 3 Dr. & War. 411.

This rule has the recognition of the Supreme Court.

*Lawrence Mfg. Co. v. Janesville Cotton Mills*, 138 U. S. 552;
*O'Brien v. Wheelock*, 184 U. S. 450;
*Lewers & Cooke v. Atcherly*, 222 U. S. 285.

It is submitted that on the Supplemental and Ancillary Bill, the Bridge Company was required to show that the decree in the Foreclosure Cause was a "right" one and Phoenix was entitled to show the contrary. Phoenix was also entitled to show circumstances of fraud and mutual mistake contributing to making that decree in capable of implementation. *In addition, Phoenix and its predecessors in interest had advanced large sums to the Bridge Company or for its benefit and the money so advanced remains un-*

*paid. Under these same authorities, the Court below should have compelled the Bridge Company to do equity and to repay to Phoenix the sum by which it has been unjustly enriched. If this were not the law, we would have the absurd result that the rights of the Bridge Company upon the Supplemental Bill would be greater than they would have been upon an original bill or upon a cross-bill for affirmative relief in the original procedings.*

## Point VIII.

**The Scope of the Decree in the Supplemental and Ancillary Proceeding Is Broader Than the Decree in the Foreclosure Cause and in Effect Substantially "Pieces Out" That Decree. The Case Is a Typical One for the Application of "Lord Redesdale's Rule."**

The essential part of the final decree in the Foreclosure Cause is as follows (F. R. 204):

> "That the bill of the plaintiffs be dismissed as to the plaintiff, Phoenix Finance Corporation, and that the prayer of the bill be denied, except insofar as the decree provides for the protection of the holders of said $15,000.00 in bonds. *That foreclosure and sale of the mortgage property be denied* * * *."

The scope of the decree as appears from the above portions thereof is an exceedingly narrow one. It is not claimed by the Bridge Company that this decree was not carried into effect or in any way requires implementation. There has been no further attempt by the Trustee under the deed of trust to enforce the security.

Phoenix as a creditor of the Bridge Company on certain underlying indebtedness has brought suit in the courts of Delaware. These suits are in no way enjoined by the

decree in the Foreclosure Cause. It is accordingly urged that in filing the Supplemental and Ancillary Bill, the Bridge Company sought to enlarge and "piece out" the original decree far beyond its original scope. To do this, it must show that the decree is a "right" one under the principle of "Lord Redesdale's Rule."

The decree of March 23, 1940, in the Supplemental and Ancillary Cause enjoins and restrains Phoenix from prosecuting or carrying forward any and all of the actions of law and equity instituted by Phoenix against the Bridge Company in Delaware. The issues involved in the cases pending in the courts of Delaware, and the issue that would be involved if the $50,000 "open" mortgage were sought to be enforced are all *subsequent* to the foreclosure decree and are in no way treated therein. That decree merely denied foreclosure of the deed of trust and dismissed the bill.

For instance the mortgage dated March 10, 1931, executed by Iowa-Wisconsin Bridge Company and recorded in Allamakee County, Iowa and Crawford County, Wisconsin, was not in issue in the Foreclosure Cause, is not referred to in any decree in that cause, and was in fact not recorded in the two jurisdictions until June 2, 1939, in Allamakee County, Iowa, and May 18, 1939, in Crawford County, Wisconsin. The Supplemental and Ancillary Bill seeks, and the decree by mandatory order directs, Phoenix to satisfy this recorded mortgage and to deliver the note for $50,000 for which it is security to the Court for cancellation. The note for $50,000 was not an exhibit in the Foreclosure Cause and there is no reference anywhere in the findings of fact of the Master or of the Court as to the existence of such a note. It is submitted that a decree which now directs Phoenix to satisfy a mortgage which was not involved in

the Foreclosure Cause and to deliver up for cancellation a note, the existence of which is unknown to the record of the Foreclosure Cause, is necessarily an enlargement and "piecing out" of the original decree.

Again, the petitioner urges that there was no issue in the Foreclosure Cause as to the right of Phoenix, as an involuntarily impleaded party plaintiff, to recover or have restored to it by the Bridge Company defendant the 517 shares of Bridge Company preferred stock which had been delivered to the Bridge Company in exchange for certain of the bonds secured by the deed of trust, the foreclosure of which was sought. *In the Delaware Chancery action, Phoenix is not seeking to recover these shares because the consideration for the exchange has been invalidated by the decree of December 1, 1936, but on entirely separate and distinct issues,* both of law and of fact. The mandatory order in this cause directing Phoenix to dismiss the Delaware Chancery action must of necessity be regarded as an enlargement of the scope of the decree in the Foreclosure Cause, not only because that decree does not deal with the subject, but also because the issues involved are entirely different.

It cannot be here said, as was stated by the court in the case of *Utah Power & Light Co. v. U. S.*, 42 F. (2d) 304, in *refusing* to apply Lord Redesdale's Rule as approved in *Lawrence Mfg. Co. v. Janesville Cotton Mills, supra,* that (p. 308):

> "But in the case at bar no modification of the former decree is sought. The plaintiff stands on the decree as it is and the case is not one in which a new trial of the former action can be had."

This case is rather one for the application of "Lord Redesdale's Rule" in supplemental proceedings to *enlarge* a de-

cree. In the case of *Gay v. Parpart,* 106 U. S. 679, the Supreme Court approved language of the Illinois Supreme Court in *Wadhams v. Gay,* 73 Ill. 415 as follows (p. 699):

> "We do not regard that it militates with the doctrine of the conclusive effect of what is *res judiccta* that where there is an incomplete decree and it is ineffective for want of the provision of any means for its execution, and an application is made to a court of equity to supply the imperfection so as to render the decree effective, then it is admissible to look at the real nature and character of the decree as it may appear in the light of surrounding circumstances for the purpose of determining whether there is such an equitable ground for action as will move a court of equity to interpose. Equity will penetrate beyond the covering of form and look at the substance of a transaction and treat it as it really and in essence is, however it may seem. * * *"

The very fact that the question before this Court has been raised by the filing of a *Supplemental* Bill [8] in the court below is indicative that the Bridge Company seeks an enlargement of an earlier decree. Such a bill presupposes some alteration in the interests of the parties arising by reason of "matter happening *after* the filing" of the original bill. It "is designed to supply some defect in the structure of the original bill."

> *Kennedy, et al. v. Bank of Georgia,* 8 How. 586, 610.

*In a supplemental bill the subsequent matter alleged must be such as to vary the relief sought under the original bill.* However, the decree of change in an earlier decree sought by the supplemental bill is not important to the application of "Lord Redesdale's Rule" so long as *some* additional relief is sought.

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[8] The bill below was "supplemental" as well as "ancillary."

In the case of *Lewers and Cooke v. Atcherly,* 222 U. S. 285, an earlier decree ordered the conveyance of property to appellant's predecessor in title. In the later proceedings, the appellant prayed in his bill that title to the property be registered and that the title be confirmed. While this relief was virtually the same as that originally sought by appellant's predecessor in title, the Supreme Court stated that under such circumstances the appellants were in "the same position as a party asking the aid of a Court of Chancery in executing a former decree, *and it is well established that he must take the risk of opening up such decree for re-examination.*" (Citing *Lawrence Mfg. Co. v. Janesville Cotton Mills, supra.*)

In the case of *American Radium Co. v. Hipp Didisheim,* 279 Fed. 601, the original decree failed to provide that its benefits should run to the successors or assigns of the original plaintiff. Ancillary proceedings were brought by one other than the original plaintiff to obtain the fruits of the earlier decree and also asking for an accounting. The Court applied the rule of *Lawrence Mfg. Co. v. Janesville Cotton Mills, supra,* and decided that the original decree was not *res adjudicata* and that the case must be considered on its merits.

In the case of *O'Brien v. Wheelock,* 184 U. S. 450, while the Court denied the relief sought in the ancillary and supplemental proceedings on the grounds of *laches,* it declared that it had the power to inquire into the former proceeding. The only material change in the supplemental proceedings was that landowners, some of whom had acquired land involved in the original proceedings many years after the original decree, were brought in as parties to the supplemental proceedings. In this case, the court

quoted from *Lawrence Mfg. v. Janesville Cotton Mills, supra*, as follows (p. 561):

> "But where a party returns to a Court of Chancery to obtain its aid in executing a former decree, it is at the risk of opening up such decree as respects the relief to be granted on the new bill."

*It is submitted that the Court below has destroyed the equitable principle inherent in Lord Redesdale's Rule by refusing to apply it to a supplemental as well as ancillary bill which seeks additional relief based upon facts that had not occurred and were not even in contemplation at the time of the decree in the Foreclosure Cause.*

## Point IX.

### The District Court in the Supplemental and Ancillary Proceeding Should, When Raised by Way of Defense, Have Taken Cognizance of the Tendered Proof of Fraud Inherent in Its Own Decree.

As a corollary to Lord Redesdale's Rule, it is held that a party may attack a judgment obtained by fraud in any subsequent proceeding thereon. The District Court, therefore, erred in rejecting the tendered proof of fraud inherent in its decree in the Foreclosure proceedings as a result of conduct on the part of the Bridge Company, the interveners, and their counsel.

*Webster v. Reid*, 11 How. 437.

There is a distinction between those cases where a party is seeking *affirmatively* to have a judgment or decree set aside on the ground of fraud and those cases (like the case *sub judice*) where a party is *defending* against a suit to enforce the alleged fraudulent judgment or decree.

Cases in the former category seem to hold generally that fraud to be available in an *affirmative* attack upon a decree must be extrinsic to the issues.

> *U. S. v. Throckmorton,* 98 U. S. 61;
> *Marshall v. Holmes,* 141 U. S. 589;
> *Atchison T. & S. F. Ry. Co. v. U. S., etc.* (C. C. A. 8) 106 F. (2d) 899.

In cases of the latter category, however, the *defending* party may offer any available evidence to show that the decree sought to be enforced is not a "right" one. This brings us back again to the application of "Lord Redesdale's Rule," discussed *supra.*[9]

Even if the rule of the *Throckmorton* case were controlling in the case of a party *defending* against the enforcement of an alleged fraudulent decree, nevertheless the evidence tendered in the court below comes within an *express exception* to the rule of that case. The Supreme Court in the *Throckmorton* case stated (pp. 65-66) that one of the "reasons for which a new suit may be sustained to set aside and annul the former judgment or decree and open the case for a new and fair hearing" is: *"where the unsuccessful party has been prevented from exhibiting fully his case, by fraud or deception practiced on him by his opponent.* * * *" (emphasis supplied).

This exception is also emphasized in the case of *Chicago, R. I. & P. Ry. Co. v. Callicotte* (C. C. A. 8), 267 Fed. 799.

Particularly is the exception stated above applicable here. Phoenix, the unsuccessful party in the Foreclosure

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[9] See also *Publicker v. Shallcross* (C. C. A. 3), 106 F. (2d) 949, wherein the Court stated as to the maxims "*interest rei publicae ut sit finis litium*" and "*memo debet bis vexari pro una et eadam causa*" (p. 952): "We believe truth is more important than the trouble it takes to get it."

Cause, was prevented from fully exhibiting its case by reason of three circumstances: (1) because of understanding, following approved Federal practice, with respect to the two-stage theory, by reason whereof Phoenix was prevented from offering its evidence, (2) because it was denied relief on petition for modification of the Foreclosure decree because of false representations of opposing counsel accepted by the Court with respect to its alleged failure to produce books as ordered, and (3) because of the circumstances of *extrinsic* fraud stated in stricken paragraph 44 of its Answer and Counterclaim (R. 166, 167).

## CONCLUSION.

It is respectfully submitted (1) that the foreclosure decree did not and validly could not adjudicate, adversely to Phoenix, the several claims, demands and choses in action involved in the Supplemental and Ancillary Cause, or, in the alternative, (assuming, *arguendo,* such adjudication) (2) that, in the Supplemental Cause, Phoenix was entitled, by evidence in support of properly pleaded allegations of its answer, to have the court reopen the former case, scrutinize the Foreclosure decree, and determine whether it was a "right" one.

James R. Morford

James R. Morford,
*Attorney for Petitioner.*

Marvel & Morford,
Zimmerman & Norman,
Casper Schenk,
*Of Counsel.*

## APPENDIX.

IN THE

SUPREME COURT OF THE STATE OF DELAWARE.

| | |
|---|---|
| IOWA-WISCONSIN BRIDGE COMPANY, a Corporation of the State of Delaware,<br>*Defendant Below,*<br>*Plaintiff-in-Error,*<br>*v.*<br>PHOENIX FINANCE CORPORATION, a Corporation of the State of Delaware,<br>*Defendant-in-Error.*<br>*Plaintiff Below,* | Term A. D. 1940.<br>No. 4 October |

THIS IS TO CERTIFY that writ of error captioned as above was argued by counsel for the respective parties before the Judges of the Supreme Court of the State of Delaware on Thursday, the 30th day of January, 1941, that all briefs required by the Rules of the Supreme Court have been filed by the respective parties, that the Court has the case under advisement, and decision is pending.

(s) W. MARION STEVENSON,
*Clerk of the Supreme Court.*

February 6, 1941.

(Seal of the Supreme
Court of Delaware )